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The Interstate Commerce Commission—The First Century of Economic Regulation

PAUL STEPHEN DEMPSEY*

This issue of the Transportation Law Journal is proudly dedicated to the centennial anniversary of the nation's first independent regulatory agency—the Interstate Commerce Commission. Transportation was the first American industry to enjoy comprehensive economic regulation, and paradoxically, the first to be significantly deregulated. That potentially makes this issue of some historical significance.

Congress created the Interstate Commerce Commission with the promulgation of the Act to Regulate Commerce of 1887. President Grover Cleveland appointed the distinguished jurist, Thomas Cooley, the first Chairman of the Interstate Commerce Commission. A complete list of all the men and women who have been appointed to the Commission is set forth in an appendix to this issue of the Journal.

A century of evolution of regulatory policy and statutory change is reflected in these pages. We begin the symposium with an article on the history of the Commission, followed by the proceedings of the ICC Centennial Celebration, which was held in Washington, D.C., on April 3, 1987. We are indebted to the officers and members of the ICC Centennial

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Planning Committee, and its chairman, Fritz Kahn, for making these proceedings available to the Journal for publication.

The Journal played no role in planning the proceedings. As the reader will see, the program was dominated by speakers advocating the prevailing contemporary philosophy in Washington—that of deregulation. In these times, when regulation has fallen into disfavor, that is to be expected. But the pendulum on such things has a tendency to swing on such important issues of economic and political policy. Government supervision of various aspects of the privately owned infrastructure industries may well return.

For the historian curious as to how the Interstate Commerce Commission was perceived at its 50th and 75th anniversaries, we recommend volumes 5 and 31 of the George Washington Law Review, respectively. In both, scholars, jurists, government officials and commentators enthusiastically applauded the excellence demonstrated by the Commission in protecting the public interest in safe, adequate, reasonably priced and dependable rail, motor and water carrier services.

For example, at the agency's fiftieth anniversary, the Commission was praised for its "vigor, spirit, and statesmanlike administration . . . ." A Congressman said of the ICC, "Without desire to aggrandize itself, but actuated by what it believed to be in the public interest, free from partisanship or politics and resisting pressure from whatever source, it does its work." At the Commission's 75th Anniversary, it was Supreme Court Justice Felix Frankfurter who eloquently summarized the agency's strengths:

[T]he Commission illustrates, throughout its life, unblemished character . . . character meaning a fastidious regard for responsibility, a complete divorce between public and private interest, and all other concomitants of a true and worthy conception of public duty. Alas, that cannot be said of all public bodies, but it can be said that this Commission throughout its seventy-five years has had a career of unblemished character.

Secondly, . . . we are here to celebrate as striking a manifestation of competence in government as any I know of in the three branches of government. . . .

Thirdly, it is a necessary condition, before a Commission can effectively act, that it be independent. . . .

It has maintained not merely formal independence, but actual independence of word and deed, and has been a laboratory demonstration of how

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1. All speakers and topics for the ICC Centennial Celebration were selected by its planning committee, the members and officers of which are set forth elsewhere in this issue.


economic problems may be worked out by trial and error. Finally, by virtue of all these considerations, the Commission has been a pacemaker, a model, for the subsequent commissions which, in turn, have been created in response to economic and social demands in their fields of activity.⁴

As you read the proceedings of the ICC Centennial Celebration, you will see what many of the contemporary critics think of the agency. Some came to bury Caesar, not to praise him. Others recognized the important work which Congress commissioned the agency to do, and urged it to look to the spirit of its past, to reassert its autonomy from the White House, and return to the responsible performance of its statutory mission.⁵ Many repeated the succinct commands of the dynamic ICC Chairman Joseph Eastman in his "Twelve Points," and these too are reproduced in the appendix to this issue.

Unless we learn from our history, we are doomed to repeat it. It is not only for the present audience, but those who follow us, that the Transportation Law Journal proudly publishes this Symposium issue devoted to the Centennial of the Interstate Commerce Commission.


100TH CONGRESS, 1ST SESSION
S.J. RES. 80

Designating April 3, 1987, as "Interstate Commerce Commission Day."

JOINT RESOLUTION

Designating April 3, 1987, as "Interstate Commerce Commission Day." Whereas the Interstate Commerce Commission was created by Congress in 1887 to implement the congressional mandate to regulate interstate transportation, and 1987 marks the one hundredth year of its continuous public service; Whereas the Commission was the first independent, quasi-judicial, administrative agency created by Congress as a pioneering concept in a growing Nation's legal system with a leading role in the development of an increasingly important body of administrative law; Whereas the one hundred-year period of the Commission's regulatory responsibility has embraced the challenge of two world wars and other major international conflicts, as well as continuous fluctuations in the Nation's economy and business cycles which span the Great Depression, postwar booms, and the beginnings of the nuclear and space ages; Whereas the Commission's record of national service has encompassed tremendous changes in technology and competition accompanying the development and growth of waterways, railroads, pipelines, motor carriers, and air carriers; Whereas the Commission has steadfastly endeavored to guard and protect the public interest in the development and regulation of the Nation's transportation system; and Whereas, under its one hundred years of regulatory oversight dedicated to the development, promotion, and preservation of a national system of transportation under a free enterprise economy, a transportation system unsurpassed throughout the world has been established: Now, therefore, be it

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That April 3, 1987, is designated as "Interstate Commerce Commission Day." The President is authorized and requested to issue a proclamation calling upon the people of the United States to observe that day with appropriate ceremonies and activities to recognize the one hundredth anniversary of the establishment of the Interstate Commerce Commission.
DAYTIME PROGRAM OF EVENTS

Friday, April 3, 1987

THE DEPARTMENTAL AUDITORIUM
WASHINGTON, D.C.

9:30 a.m. Welcome
The Honorable Heather J. Gradison
Chairman, Interstate Commerce Commission

9:40 a.m. Keynote address
The Honorable James C. Miller, III
Director, Office of Management and Budget

10:00 a.m. Panel: History of the ICC—Perspectives from Within
George M. Chandler
Beatrice Aitchison
Moderator: Hon. Robert W. Minor
Robert L. Calhoun
Robert S. Burk

11:15 a.m. Panel: Administrative Law and the ICC—Their Evolution
Hon. John R. Brown
Gary J. Edles
Moderator: Hon. Betty Jo Christian
Joseph Auerbach
Victor G. Rosenblum

12:30 p.m. Lunch (open)

2:00 p.m. Panel: Congress and the ICC—the '80s Legislation
John J. Fryer
John M. Kinnaird
Moderator: Hon. A. Daniel O'Neal
Janice M. Rosenak
William K. Ris, Jr.

3:15 p.m. Panel: Transportation Without Regulation
Dr. Frederick C. Thayer
Dr. Thomas Gale Moore
Moderator: Hon. Marcus Alexis
OFFICERS AND MEMBERS OF
THE ICC CENTENNIAL PLANNING COMMITTEE

FRITZ R. KAHN, ESQ.  President
JOHN M. CLEARY, ESQ.  Vice-President
THOMAS C. DORSEY  Secretary
PETER A. GREENE, ESQ.  Treasurer

JAMES E. BARTLEY, National Industrial Transportation League
P. HOWARD CROFT, The American Short Line Railroad Association
WILLIAM H. DEMPSEY, Association of American Railroads
THOMAS J. DONOHUE, American Trucking Associations
HON. HEATHER J. GRADISON, Interstate Commerce Commission
LELAND E. BUTLER, Association of Transportation Practitioners
CARL D. MARTLAND, Transportation Research Forum
PAUL RODGERS, ESQ., National Association of Regulatory Utility Commissioners
PETER M. SHANNON, JR., ESQ., Transportation Committee,
Section of Administrative Law, American Bar Association
A. CHARLES TELL, ESQ., Transportation Lawyers Association

Dr. Beatrice Aitchison, Mark J. Andrews, Esq., Thomas J. Byrne,
Peter J. Gatti, Jr., Michael Keyes, William J. Love, Edward Margolin, William G. Norris, Nancy Wilson

The Committee is a District of Columbia nonprofit corporation.
Getting Started: Organization, Procedure and Initial Business of the ICC in 1887

Leonard S. Goodman*

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The Act to Regulate Commerce was signed by President Cleveland on February 4, 1887, making the provisions on appointment and organization effective on that date; the remaining sections of the Act became effective 60 days later on April 5, 1887. President Cleveland required nearly this entire 60-day period to complete his five appointments, which were announced on March 22, 1887.

This paper will explore how these five appointees organized themselves for business, the procedures they developed, and the initial business they conducted in the first few months. This period long preceded the day the Supreme Court would characterize the Commission as "a

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* Special Projects Counsel (1973-74) and Associate General Counsel (1960-73) to the Interstate Commerce Commission, Mr. Goodman is currently in private practice as a legal consultant in utility and transportation matters.

tribunal appointed by law and informed by experience." 2 There had been no prior experience with Federal regulation under the Commerce Clause of a national business by an administrative commission. The country waited to see how it would conduct itself.

The earliest Commission has been accused of holding a "modest conception" of its mandate and a "hopeless bias" against the railroads. 3 At the same time, another student of the railroad industry claims that the early commissioners were only the first in a long line who systematically betrayed the spirit of the new legislation under "strong pro-railroad predilections." 4 Neither assessment fairly reflects the record that the new commission made for itself in its earliest period of formation. Far from perfect, it nonetheless laid the seeds for the later administration of the statute in the public interest.

1. ORGANIZATION

Snow was falling and the Washington streets were wet when the five lawyers from different sections of the country met on March 31, 1887, to take their oaths of office. They had made an informal call on the President, and they were convened in the offices of the Secretary of the Interior with whom the new statute required them to confer. 5 They had each been appointed for different terms of office. All pomp was missing from the ceremony as a notary administered the oaths.

By far the best known of the new commissioners was Thomas McIntyre Cooley, a constitutional scholar and former Chief Justice of the Michigan Supreme Court. The others, less well-known nationally, had governmental backgrounds and even some regulatory experience at the State level. The terms of office, total periods of service, and relevant

5. The Secretary was obligated to furnish the Commission with offices and supplies, and was empowered to approve the hiring of personnel, the amounts of employee compensation, and the payment of expenses. 24 Stat. 386 (1887). The commissioners did not consider themselves a bureau of the Department of the Interior, although they agreed to be shown with the Department in the "Blue Book" of government offices. See Diaries and Personal Memoranda Books of Thomas M. Cooley, 1824-1898, Univ. of Mich., Mich. Historical Collections (hereinafter cited as COOLEY DIARY), Oct. 15, 19, 1887. There is no evidence that the Secretary exercised any direct or indirect control; he soon advised Congress that the new commission should be "authorized to report directly to the President; to appoint its own officers and employees; and to draw upon the Treasury for the payment of the salaries of its subordinates as well as for all expenses incurred under the act." Report to Congress of the Secretary of the Interior, 1887, at 57. These statutory changes formally occurred with the amendments of March 2, 1889, 25 Stat. 855 (1888).
backgrounds of the first commissioners are set forth in the following table.  

### SUMMARY PROFILES OF THE ORIGINAL ICC COMMISSIONERS

<table>
<thead>
<tr>
<th>Name</th>
<th>Term of First Appointment</th>
<th>Total Service (incl. reapppt.)</th>
<th>Relevant Background</th>
</tr>
</thead>
<tbody>
<tr>
<td>William R. Morrison</td>
<td>5</td>
<td>'' - Dec. 31, '97</td>
<td>State legislator Congressman</td>
</tr>
<tr>
<td>Augustus Schoonmaker</td>
<td>4</td>
<td>'' - Dec. 31, '90</td>
<td>Judge, legislator, Atty-gen., State Civil Svc. Commissioner</td>
</tr>
<tr>
<td>Walter L. Bragg</td>
<td>2</td>
<td>'' - Aug. 21, '91</td>
<td>Chairman of the Ala. R. Comm.</td>
</tr>
</tbody>
</table>

A contemporary picture of the five new commissioners appears on the page opposite. Full beards were the Victorian style; and these were conservative, practical men of that period.

Cooley was serving as the receiver of the Wabash Railroad when he received his appointment; he had been involved in many other railroad affairs, and had written and spoken widely on railroad matters. The Cullom Committee paid particular attention to his views during the hearings on the new railroad act. His colleagues unanimously elected him chairman of the new commission immediately following their swearing in on March 31, 1887.

President Cleveland had granted the longest term of office (a full six-year term) to Chairman Cooley at his request. It is said that Cooley had

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6. See Miller, The Interstate Commerce Commissioners: The First Fifty Years: 1887-1937, 5 Geo. Wash. L. Rev. 580-700 (Mar. 1937); 4 I. L. Sharfman, The Interstate Commerce Commission, 12-41 (1937); The appointments were made and the oaths taken during a Senate recess. The appointments were submitted for confirmation on Jan. 4, 1888, and confirmation was given on Jan. 16, 1888.


8. First I.C.C. Minute Book, Record Group 134, National Archives, Washington, D.C. (hereinafter cited as Minute Book), Mar. 31, 1887, at 3. Cooley noted in his diary. "By common consent I was made Chairman of the Commission." COOLEY DIARY, supra note 5, Mar. 31, 1887.

9. Cooley wrote in his diary, that he answered President Cleveland's tender of an appointment on March 11, 1887, the same day it was received, "by telegraph that I should defer to his
Hon. Augustus Schoonmaker, of New York.

Hon. William R. Morrison, of Illinois.

Hon. Thomas M. Cooley, of Michigan.

Hon. Walter L. Bragg, of Alabama.

Hon. Aldace F. Walker, of Vermont.

The Interstate Commerce Commission
been reluctant to accept the appointment.\textsuperscript{10} True, he later expressed some recriminations and doubts, as he became overworked and very ill during his term of office;\textsuperscript{11} but his requesting a long term of appointment does suggest an initial eagerness and commitment to the task, which his acceptance of the chairmanship and his leadership thereafter only confirm.

In fact, the record of this early period in the Commission's history largely reflects the energy and thought of Chairman Cooley. The Commission often deferred to his judgment in this early period; and even when he despaired in later years that the Commission was taking a too narrow view of its jurisdiction, in all honesty he could write in his diary of 1889, however the fact might be as to our differing views of the law, I must admit that I had been allowed to shape the action and policy of the Commission in the past . . . \textsuperscript{12}

The Secretary of the Interior assigned rooms to the new commissioners in the Hooe Iron Building at 1330 F Street, N.W., in Washington, which was then occupied by the Geological Survey. The commissioners occupied these quarters for only two weeks. On April 15, 1887,\textsuperscript{13} they located their headquarters across the street on the fifth floor of the newly constructed Sun Building at 1315 F Street (now 1317 F Street). This new eight-story, marble-fronted, structure had been built by the Baltimore

\textsuperscript{10} See Friendly, The Federal Administrative Agencies: The Need for Better Definition of Standards, 75 HARV. L. REV. 863, 885, note 100 (1962); see also Jones & Alan, Thomas M. Cooley and the Interstate Commerce Commission: Continuity and Change in the Doctrine of Equal Rights, 81 POL. SCI. Q. 602, 612 (1966). The confusion may have arisen over the letter from Cooley to his wife, which these sources rely on, in which Cooley had earlier responded to the rumors of his appointment by stating, "I don't think there is anything in it for me to feel elated," perhaps referring then only to the prematureness of any such feeling, rather than to his lack of eagerness for the position.

\textsuperscript{11} Cooley wrote in his diary for September 19, 1889, that when he returned to Washington from the West, he wanted to determine whether, as he suspected, Commissioner Bragg, who had assumed "a general charge of our affairs," had been "acting in some respects foolishly" and had departed from "our general policy." He determined either to assume "control hereafter or to leave the Commission." In this mood, he found the "opportunity for a full & free talk with Col. Morrison" at the next hearings in Indianapolis, when he told Commissioner Morrison, "that as he knew very well I never wanted the office of Commissioner & my family had never wanted me to take it . . . I ought to resign provided I could assign to the public satisfactory reasons for doing so." Morrison assured him that he was needed on the Commission: "If I left, he said, the Commission might as well dissolve." Morrison then apparently spoke to Bragg, who "was soon mellow, & almost oppressively anxious to do anything he thought I was likely to want done." Cooley was clearly overworked and his health was failing. Less than a month later, he left Washington for home in Michigan "in a condition of partial paralysis" and returned only in December. COOLEY DIARY, supra note 5, Nov. 1, 1889, and Christmas, 1889.

\textsuperscript{12} COOLEY DIARY, id. Nov. 1, 1889.

\textsuperscript{13} 1 Interstate Commerce Reports (hereinafter cited as I.C.R.) 18 (1887).
Sun; and was the tallest privately owned office building at that time in the city. Even today it retains much of the splendid wrought iron, polished brass railings and other interior adornments of its past, although the imposing spire has long since been removed. The Commission expanded onto the sixth floor of the Sun Building the following year. It continued in this building, adding additional floors as well as supplementary space elsewhere, until 1917. An exterior view of the Sun Building, when construction was completed in 1887, is shown on the opposite page.

The Commission filled the statutory position of Secretary on April 19, 1887, by appointing Edward A. Moseley of Massachusetts, whom they also designated their Special Disbursing Agent. A few days earlier the Commission had hired five clerks (at $100 per month each) and a messenger (at $60 per month). The circumstances surrounding the Secretary’s appointment and the hiring of the clerks may explain some of the problems the Commission was to experience with the workload.

The Commission’s first Secretary would serve as the chief administrative officer of the new agency, managing the flow of the hundreds of pieces of correspondence19 that the agency soon would receive. However, there was nothing in Moseley’s background that would have justified his appointment as office manager of the new agency. He had been a sitting member of the Massachusetts legislature at the time of his appointment, and that State’s candidate for an I.C.C. commissioner. The President apparently decided that he would like to have Moseley ap-

16. In 1914, the Interstate Building was constructed for the Commission’s use adjoining the Sun Building, as the Commission’s need for space increased. CROSLAND, id.; and caption to a photograph of the building in Misc. Historical Materials, Record Group 134, National Archives, Washington, D.C., Carton No. 3.
18. MINUTE BOOK, supra note 8, at 21-22. His temporary bond was set at $2,000 and his permanent bond at $5,000. The Commission then advised the Secretary of the Interior regarding the appointment and the amount of the bond. Id. at 22; Cooley to Secty. Lamar, Apr. 19, 1887, Letter Book No. 1 of the I.C.C., Apr. 1, 1887-May 17, 1887, Record Group 134, National Archives, Washington, D.C. (hereinafter cited as LETTER BOOK) at 214-15.
19. MINUTE BOOK, supra note 8, at 10, 14. When the commissioners reached Washington and had been sworn in, they found that, “Applications for appointment under the Commission are very numerous.” COOLEY DIARY, supra note 5, Mar. 31, 1887.
19. The reference to “over 1,000 complaints, grievances, and questions . . . within a few months” in KOLKO, supra note 4, at 49, is safe enough. See Files of the I.C.C. Operating Division, 1887-1906, Record Group 134, National Archives, Washington, D.C. (formerly stored at the G.S.A. Warehouse in Springfield, VA). See also the concise and interesting monograph entitled, A. & O. HOOGENBOOM, A HISTORY OF THE ICC: FROM PANACEA TO PALLIATIVE, at 21 (1976).
THE SUN BUILDING
FOLLOWING COMPLETION OF CONSTRUCTION IN 1887
pointed Secretary; and acting on that advice, the Commission chose him for the position.

Although the new Secretary was later to win some distinction for his efforts on behalf of railroad labor by championing federal statutes like the Safety Appliance Acts, he had, as his biographer notes, "no special experience and no natural aptitude" for administration, such as "the work of establishing the routine of his office"—and "he knew nothing of law and judicial forms." All this was to change in the next few years, but his initial incompetence led to extreme awkwardness in his early relations with the demanding Chairman Cooley, greatly complicated the earliest efforts to organize the Commission's work, and imposed additional burdens on the commissioners, particularly the Chairman.

For example, when the commissioners left Washington to hold hearings in the South in the latter part of April, 1887, Chairman Cooley left a "Memorandum for Secretary during absence of Commission," specifying that the Secretary was to,

1. Enter applications and complaints in their respective Dockets;
2. Answer letters of inquiry from answers previously given; if no prior answer was available, simply acknowledge the letter;
3. Send complaints to defending railroads for answer;
4. Acknowledge receipt of section 4 applications with a notice of the Commission's absence from the city.

In other words, virtually nothing new could go forward during the Commission's absence from Washington. As late as September, 1887, Cooley was writing in his diary:

I have today been very busy with correspondence. Our Secretary is so stupid a fool he keeps me anxious about matters in the office constantly. Wednesday [Sept. 7, 1887] in a letter he inclosed [a] copy of a petition which he said he had docketed, finding it all proper. This was a liberty on his part, and looking at the copy I saw it was one I should not have docketed. I immediately telegraphed him to do nothing in that case till he got a letter from me, and then wrote him that there were other matters involved in docketing a case besides those of form.

On October 8, Cooley described the encounter he had had with Moseley back in April, adding that ever since then Moseley "has been afraid of

21.  J. MORGAN, THE LIFE WORK OF EDWARD A. MOSELEY IN THE SERVICE OF HUMANITY, at 31 (1913). Morgan maintains, and he quotes from correspondence to show, that a close and warm friendship eventually formed between Moseley and Chairman Cooley. Id. at 32-36.
22.  MINUTE BOOK, supra note 8, at 28. Although the Memorandum refers to "Dockets" for applications and complaints, the first reference to a specific docket number in the minutes occurs in June of 1887. Id. at 66.
23.  COOLEY DIARY, supra note 8, Sept. 10, 1887. In the same vein, he wrote on October 8, "Our Secretary is a great trial to me."
Getting Started

me'" and "accomplishes his ends as far as possible without coming to
me.'"

Similar problems were inevitable with the first group of clerks em-
ployed by the Commission. The patronage reflected in the Moseley ap-
pointment was not an isolated case. All appointment and employment of
personnel was treated as a matter of patronage, so that each commis-
sioner was allowed to appoint one of the first five clerks.24

Yet, the volume of new work was daunting. Besides the flood of cor-
respondence, the railroad industry in 1887 filed about 110,000 books,
papers, and documents showing rates, fares, and charges, as well as
copies of contracts or other arrangements for transportation.25 Although
the Commission's First Annual Report claims that the tariffs had been in-
dexed and "put . . . in order for reference," a later assessment suggests
that the papers were initially dumped on the floor of a vacant room and
were not completely filed for three years.26

The Commission’s staff during its first year was quite small. There
were no employees to offset the political appointees. The Commission’s
Second Annual Report (for the fiscal year ending June 30, 1888) shows
only eight clerks and two messengers on the payroll for twelve months, or
a total of ten employees as of July 1, 1887. For the first two weeks in

24. CROSLAND, supra note 15, at 8-9. Chairman Cooley diplomatically characterized the
Commission’s hiring "on personal knowledge of fitness." Cooley to English, Apr. 16, 1887,
LETTER BOOK, supra note 17, at 135. The Commission’s auditor complained to Chairman Cooley
in August that three of his four clerks "seem willing enough but they are imbued with Washington
ways which I find so very slow compared to the business like methods to be found in most
railroad offices." McCain to Cooley, Aug. 17, 1887, First Letter Book, I.C.C. Dept of Statistics,
August, 1887 to March, 1888, Record Group 134, National Archives, Washington, D.C., at 35.
Crosland adds that hiring on the basis of patronage generally continued until the creation of the
civil service in 1896.

25. I.C.C. First Annual Report, 1887, at 24, reprinted in Report to Congress of the Secretary
of the interior for 1887, at 1094. CROSLAND, supra note 15, at 8, maintains that the majority of
the new tariffs were filed in early April, 1887. However, Moseley was still acknowledging the
receipt of tariffs from a major carrier like the Northern Pacific at the end of April. See Moseley to
Hannahford, Apr. 30, 1887, LETTER BOOK, supra note 17, at 366; and other tariffs arrived from
other carriers in May. See Hubbard to Cooley, May 10, 1887, id. at 411-13. The Commission
initially required all carriers participating in joint tariffs to file separate tariffs. See Walker to
Gerriond, Superint’d., N.Eng.Transf.Co., Apr. 4, 1887, id. at 30: "The fact that these documents
are likely to be filed by the other corporations with which you are associated would not of itself
relieve you from the obligations imposed by the Act. The foregoing are our general views, of first
impression. . . ."

26. CROSLAND, supra note 15, at 8. Two of the original clerks were still alive when Crosland
delivered his address.

The Commission created a separate Bureau of Statistics to monitor the tariffs and to provide
statistical analyses in July, 1887. 1 I.C.R. 354-55 (1887), which in October soon undertook
to collect data on potential cases of discrimination in violation of Section 4 of the act. See 1 I.C.R.
601 (1887). The Commission separated statistics from tariffs in the summer of 1888. CROSL-
LAND, supra note 15, at 8.
April, 1887, the Commission had but one messenger and one clerk; the
next four clerks joined the staff in the third week.27

There was insufficient appropriation for a much larger staff in the first
year. The first appropriation of $100,000 was for the fiscal year ending
June 30, 1888, but was made available from February 4, 1887. The total
expenditures for fiscal years ending June 30, 1887 and June 30, 1888
were $113,000; thus, the Commission expended about $13,000 in the
three-month period of March 31 to June 30, 1887. Since the commissioner-
ers were each paid $7,500 per year, and the Secretary received $3,500
per year, the Commission paid out on the average only about $900 per
month in the first three months for all other expenses, including employ-
ees' salaries, travel, and office space, supplies and furnishings:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total expenditures—3 mos.</td>
<td>$13,000</td>
</tr>
<tr>
<td>Commissioners' salaries</td>
<td></td>
</tr>
<tr>
<td>(5 x $7,500 x 3/12)</td>
<td>$9,375</td>
</tr>
<tr>
<td>Secretary's salary</td>
<td></td>
</tr>
<tr>
<td>($3,500 x 3/12)</td>
<td>875</td>
</tr>
<tr>
<td>Sub-total</td>
<td>10,250</td>
</tr>
<tr>
<td>Balance for All Other Exp.</td>
<td>$2,750</td>
</tr>
</tbody>
</table>

On the other hand, a small staff in the beginning was consistent with
the overall manner in which the Commission took up its tasks, and the
manner in which they envisioned the new commission would continue to
function. They expected a mixture of formal and informal, but always per-
sonal involvement in the work of the agency, which is most closely analo-
gized to the functioning of a new court.

2. CASE-BY-CASE APPROACH

Judge Cooley foretold that the new commission would proceed on a
case-by-case basis even before the commissioners took their oaths of
office. He " unofficially expressed his opinion" to a New York Times re-
porter on March 30, 1887,

that it would be impossible to interpret the law until cases making such inter-
pretation necessary should come up in practice, and he thought it would be
best for the commission to take up in order the questions as they should
arise and determine what interpretation should be given to the provisions
applicable to each case.28

Similarly, soon after being sworn, he answered a letter relating to the
Commission's jurisdiction in the following manner:

Its functions, except in the special cases in which it is empowered to sus-

27. MINUTE BOOK, supra note 8, at 14. Crosland suggests that the Commission must have
employed a temporary typist, since the first typewritten letter appears as early as April 18, 1887.
CROSLAND, supra note 15, at 7. The first typewritten pages of the letter books appear on May 14,
1887.
pend the operation of the law, correspond to those of a Court, and it only speaks authoritatively when complaints are made that the law is violated.29

Since three of the five original commissioners had held judicial positions at the State level at some time in their lives, and a fourth had been counsel to a number of railroads,30 it might have seemed inevitable just from their backgrounds and training that the initial Commission would have opted for a case-by-case approach to railroad regulation. Section 17 of the Act also required the Commission to adopt rules of practice that "[conformed], nearly as may be, to those in use in the courts of the United States."31 But, besides the statute and personal backgrounds that emphasized the settlement of legal disputes case-by-case, there were sound reasons for an initial case-by-case approach.

The report of the Culom Committee in 1886, which fathered the Act to Regulate Commerce, had likened the new commission to a court that would enforce the rules prescribed by Congress prohibiting unjust practices. A commission could adjust differences between shipper and carrier and collect and publish accurate information concerning the affairs of the railroads.32 This portion of the report ended with the following significant reference to the words of Judge Cooley:

The committee believe with Judge Cooley that this final solution is "likely to be found in treating the railroad interest as constituting in a certain sense a section by itself of the political community and then combining in its management the State, representing the popular will and general interests, with some definite, recognized authority on the part of those immediately concerned, much as State and local authority are now combined for the government of municipalities. Something of the sort would neither be unphilosophical nor out of accord with the general spirit of our institutions."33

Here, attention must be given to the words, "with some definite, recognized authority on the part of those immediately concerned." The only such authority to reach unjust practices affecting individual shippers throughout the nation at that time was judicial authority.

The unjust practices affecting shippers had to be found and documented. A forum had to be in place for complaints to be heard and decided. Any part of the entire "vast extent of our country" provided a potential setting for the Commission’s supervision and correction of rail-

29. Cooley to Bishop Knickerbocker, Apr. 18, 1887, LETTER BOOK, supra note 17, at 157, 1 I.C.R. 21 (1887).
30. Chairman Cooley and Commissioner Schoonmaker had been State court judges; Commissioner Morrison had served as the clerk of a county court; and Commissioner Walker’s firm had a large railroad practice. See Miller, supra note 6, at 592-600.
31. Sec. 17, 24 Stat. 386 (1887).
33. id. at 215, Appendix at 12.
road rates. In these circumstances, it necessarily would have to await cases brought to its attention to give it a practical basis for action.³⁴

Under the new statute, the Commission was an alternative forum to a court for any shipper who believed he was charged unreasonable or discriminatory rates. A person seeking damages was required to elect whether to proceed in court or before the Commission;³⁵ and its orders then were not self-enforcing, but only enforceable in court.³⁶

At the same time that the statute created the commission as an alternative to the courts to hear and determine complaints, it gave the new agency superintending powers over the railroads that no court, except perhaps as receiver in bankruptcy, possessed. The Commission was authorized “to inquire into the management of the business of all common carriers subject to the provisions of this Act.” The Commission was both required “to keep itself informed” and authorized to obtain “full and complete information” from the carriers. It need not await the filing of complaints before it could proceed, since it was also granted “full authority and power at any time to institute an inquiry, on its own motion . . . as to any matter or thing concerning which a complaint [was] authorized to be made . . . or concerning which any question [might] arise under any of the provisions of the Act, or relating to the enforcement of any of the provisions of this Act.”³⁷ It was then empowered to make any order as if it had been appealed to by complaint or petition (except an order for the payment of money).³⁸ However, these were powers that no group of five men without precedent or regulatory experience could begin to assert.

Chairman Cooley’s experience did extend to a recognition of a difference between the administrative process and the judicial process as a matter of constitutional law. He had written the following on constitutional principles:

Different principles are applicable in different cases, and require different forms and proceedings; in some they must be judicial; in others the govern-

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³⁴ See Chairman Cooley’s detailed description of the large task confronting the Commission, and his attempt to educate a merchant on the legal and practical necessity for a certain minimum informational content of a complaint, reprinted at 1 I.C.R. 408-10 (1887).

³⁵ See § 9, 24 Stat. 382 (1887).

³⁶ See § 16, 24 Stat. 385-86 (1887). If a railroad refused to file rates, the Commission could only apply under the 1887 statute to a Federal court for a writ to compel the filing or for an injunction to prevent them from receiving or transporting the affected traffic. Sec. 6, 24 Stat. 381 (1887). Violations of the act were misdemeanors punishable by fine in any district court. Sec. 8, 24 Stat. 382 (1887); there was also the possibility of imprisonment of railroad officials for acts of discrimination. Sec. 10, 24 Stat. 382 (1887).

³⁷ Sec. 12, 24 Stat. 383 (1887).

³⁸ Sec. 13, 24 Stat. 384 (1887). For discussion of the Illinois statute of 1873, which created the precedent for a strong commission that would represent the shipper in court, see MILLER, RAILROADS AND THE GRANGER LAWS, at 93-96, 197 (1971).
ment may interfere directly, and *ex parte.*... 39 Or, as he had stated more succinctly on another occasion, "Administrative process of the customary sort is as much due process of law as judicial process." 40 Chairman Cooley would have been the first to insist, however, and with justification, that general doctrines of constitutional administrative process do not automatically translate themselves into practical rules of conduct for a national railroad industry without prior regulatory experience; the case-by-case approach to regulation could bring that experience.

The Act to Regulate Commerce was an enactment in which Congress, as Judge Friendly much later so aptly said, simply told the agency to do its best without any listing of its powers or even scanty directions on how to exercise them. 41 A case-by-case approach was called for where the agency entered *terra incognita* and "did not know enough to draft a useful rule." The agency in such cases must wait until its "consideration of a problem has progressed to the point at which a specific legal standard has crystallized." The particular case in the meantime would afford a stimulus for action that otherwise might be long delayed. 42

A significant benefit accruing to the Commission from its Chairman's judicial bent was the highly cultivated ethical sensibility that he imparted to his colleagues and imbued in his office. Cooley's resistance to profiting from his office was tested quite early and more than once. He turned down a payment of $100,000—a very large sum in that period—for the use of his name in an investment scheme for one year. Then in October of 1887 he was offered the presidency of a major railroad. He initially responded, 1) he would only leave "honorably and without any just imputation because of my abandonment of the public service;" and 2) he must be assured he was "wanted on strictly business principles" and not "to give respectability to schemes I do not approve." 43 He declined the ap-

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40. Opinion by Cooley, then Associate Justice, for the court in *Weimer v. Bunbury,* 30 Mich. 201, 214 (1874).

41. The "Great Divide" between the giving of instructions by Congress and simply telling the agency to do its best came in the Transportation Act of 1920, ch. 91 § 400, 41 Stat. 456, 474 (1920). *See FRIENDLY, BENCHMARKS,* at 96 (1967) (hereinafter cited as BENCHMARKS).

42. *Id.* at 146, referring specifically to Securities and Exchange Commission and Federal Trade Commission matters, but applicable more generally.

Even a rather severe critic of the Commission's performance after 1910 agrees that "the great problem" of the first decades of the Commission was the fairness of rates vis-a-vis one shipper and another or one location and another. *See ENTERPRISE DENIED, supra* note 3, at 175.

43. *COOLEY DIARY,* supra note 5, Oct. 5-6, 1887. The Chairman returned free passes that were sent him by the railroads with a simple thank you, but "the Commission never makes use of them." Cooley to Waite, May 14, 1887, LETTER BOOK, supra note 17, at 462, 463.
pointment on October 17, stating in his diary, "that I could not now honorably and with justice to my associates give up my present position."

3. DAILY ROUTINE

The cold and wet weather continued on April 1, 1887, when the commissioners met promptly at 10 a.m. for their first public session. They resolved on motion of one of their members that their "official hours," or "hours of meeting," each day should be from 10 a.m. to 1 p.m. and from 3 p.m. to 5 p.m.; and they "sat" during those hours this first day.44 Counsel for four railroads presented applications for relief from Section 4 of the new statute;45 and the Commission ordered it to be placed on file.

The next day, April 2, 1887, was Saturday, but the commissioners again met at 10 a.m. One of the first items of business was that the Commission ordered that it would issue no orders at the request of railroads or shippers in the absence of a verified petition:

That application made for the official action of the Commission shall be made by petition, which shall set forth the facts on which they are founded and be verified by the oath of the applicant or of some authorized agent or attorney.46

"The Commission sat all day and heard applications under the long and short haul clause" of Section 4.47 Applications were received from three railroads for relief from the requirements of Section 4. A representative of the Atlanta Board of Commerce appeared to support the railroads' applications. In the afternoon, the Commission entertained a formal request from the major southern railroads for temporary suspension of the long and short haul clause of Section 4;48 and representatives of their association were heard on the joint application.49 The case-by-case approach on the second day of the Commission's existence as a collegial body had spawned a broadly based proceeding of a type that we today might associate with rulemaking.

Much of April 4 was spent in examining the qualifications of the several applicants for the position of Secretary.50 April 5 was "the first day on which we have power under the law to make orders and we made some," temporarily relieving the territory embraced in the petition of the

44. COOLEY DIARY, supra note 5, Apr. 1, 1887; MINUTE BOOK, supra note 8, at 4.
45. The "long and short haul clause" of Sec. 4, 24 Stat. 380 (1887), provided that no greater charge should be made for the shorter than for the longer distance between two points, unless the Commission authorized a departure from the general rule.
46. MINUTE BOOK, supra note 8, at 5-6, 1 I.C.R. 15 (1887).
47. COOLEY DIARY, supra note 5, Apr. 2, 1887.
48. MINUTE BOOK, supra note 8, at 5.
49. Argument of Milton H. Smith on behalf of the Southern Railway and Steamship Assn., reprinted in LIGHT ON THE LAW, supra note 7, at 191-207.
50. COOLEY DIARY, supra note 5, Apr. 4, 1887.
members of the southern railroads' association from the requirements of Section 4.\(^{51}\) The 90 day order, released on April 6, established a schedule of hearings for later in April and early May at four different Southern cities (Atlanta, Mobile, New Orleans, and Memphis), and invited interested persons to appear or to submit written statements.\(^{52}\) Much of April 6 and 7 was spent reviewing applications for employment before the commissioners dispersed for the Easter holiday.\(^{53}\)

The Commission's Minutes now begin to reflect a pattern in the Commission's sessions or sittings. The Minutes report that each day at 10 a.m. the "Commission met pursuant to rule," that the Commission then went into "Recess," and that thereafter it "reassembled pursuant to rule." At the end of the day, as the Minutes state, the Commission "adjourned for the day."\(^{54}\)

The phrase "General Session" first appears in the Minutes only in mid-May after the Commission had held its hearings in the South and had returned to occupy its new headquarters in the Sun Building. On May 17 the Commission ordered that it would adhere to the following daily order of business while in Washington:

1. A private session at 10 a.m. for reception and disposition of new business;
2. A public session at 11 a.m. for hearings assigned and the consideration of any other matters that may be presented; and
3. A private session at 3 p.m. for disposition of unfinished business and for conference.\(^{55}\)

The revisions of May 17 reflect several new developments in Commission practice. Prior to that date, all sessions were public; the commis-

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51. *Id.* Apr. 5, 1887.
53. Judge Friendly characterized this "beautifull" decision as a "model for administrators." His discussion of the decision, the subsequent history of the administration of Section 4, and the resulting interplay with Congress, are available in his Holmes Lectures, and will not be repeated. *See* Federal Administrative Agencies, *supra* note 10, at 883-90. For other parts of these thoughtful lectures, see Friendly, *The Federal Administrative Agencies: The Need For Better Definition of Standards*, 75 HARV. L. REV. 1055 and 1263 (1962); portions also appear in BENCHMARKS, *supra* note 41.
54. COOLEY DIARY, *supra* note 5, Apr. 6-7, 1887. "The importunities of office seekers are continuous & desperate." *Id.* Apr. 6, 1887.
55. *See also* Cooley to Parsons, Apr. 7, 1887, LETTER BOOK, *supra* note 17, at 63: "The commission has now adjourned for 8 days." Moseley to Rev. Wheeler, May 10, 1887, *id.* at 410: "The Commission is not now in session, but convenes again May 16th, and the submission of any papers cannot be made until that date."
sioners now saw the need for time for reflection, consultation, and the assignment of work among themselves. In a "public session," the doors of the Commission remained open each day for any interested person to request relief orally or to place his views in the files. Applications for Commission orders, as we noted earlier, had to be presented by verified petition, or, as the Chairman explained, "Petitions for action by the Commission require to be verified as for judicial action." The Commission was serving much like a low level court.

Prior to May 17, the Commission's Minutes do not at all reflect the major work of that period relating to the disposition of the large amount of correspondence received each day. Much of this had been handled by the Chairman; but there was now clearly too much for one person. After May 17 the Minutes show that incoming letters are being assigned and recorded for disposition by named commissioners.

The commissioners held fast to a belief that each piece of correspondence, except for routine acknowledgment of the receipt of letters or the repetition of a prior response, called for their personal involvement. The commissioners looked upon each letter that requested an interpretation or an opinion as in itself a potential case for decision. As late as 1889, the Commission reported to Congress that the commissioners still:

personally examine all complaints received, hear the trial of all controversies, conduct investigations, prepare all reports made, decisions rendered, and orders and circulars issued, allow subpoenas duces tecum, carry on the correspondence relating to the action and duties of carriers and the rights of shippers, and various other things.57

Such a vast, self-imposed mandate necessarily required some self-imposed limitations. The next section discusses the rules of practice and procedure and the limitations that the Commission developed to convert the avalanche of correspondence into substantive rulings.

4. PRACTICE AND PROCEDURE

Lawyers practicing in the Federal courts of the 1880's were governed by the numerous equity rules prescribed by the Supreme Court and the "practice, pleadings, and forms and modes of proceeding" in actions at law in the State in which each Federal court was sitting.58 Federal equity practice assumed that the lawyer was familiar with the traditional

56. Cooley to Wilson, Apr. 4, 1887, LETTER BOOK, supra note 17, at 17.
57. I.C.C. Third Annual Report at 3 (1889). This report was the first to be submitted by the Commission directly to Congress and not through the Secretary of the Interior.
58. The Equity Rules in effect in 1887 had been in effect since 1842, see 42 U.S. (1 How.) xli (1843), and would not be revised until 1912. See Rules of Practice for the Courts of Equity of the U.S., 226 U.S. 627. The practice in actions at law was governed by the Conformity Act of 1872, ch. 255, 17 Stat. 196 (1872).
chancery practice in the States; the Federal rules modified or clarified, rather than rewrote the traditional practice. Federal practice in the Victorian period, therefore, maintained the separation of law and equity and the role of the many forms of writs and pleadings associated with the two sides of the court.

The Act to Regulate Commerce freed the new commission from the technicalities of common law practice and procedure. The statute described a wholly new and simplified "complaint" practice. It authorized the Commission to accept a complaint filed against a railroad in the form of a simple "petition, which shall briefly state the facts." It was then the Commission's duty to forward "a statement of the charges thus made" to the defending railroad(s) and to call upon the railroad(s) "to satisfy the complaint or to answer the same in writing within a reasonable time." If the complaint were not satisfied, or there was any reasonable ground for investigation, the Commission was required "[to investigate the matters] complained of."59

Similarly, the statute laid down new rules for the courts to follow when enforcing a Commission order. The enforcing court was required to proceed "as a court of equity, and without the formal pleadings and proceedings applicable to ordinary suits in equity, but in such manner as to do justice in the premises."60

Chairman Cooley at once undertook to channel the flow of correspondence into the statutory stream of complaint and satisfaction or complaint and answer authorized by the statute. He treated each piece of shipper correspondence as an "informal complaint," if it raised matters within the jurisdiction of the Commission and set forth sufficient facts to raise an issue for decision. It might be returned for verification, but if it failed in one of the more essential respects, he treated the letter as a potential complaint to be shaped and guided, or discouraged (if clearly outside the Commission's jurisdiction) to further the broad purposes of the new statute.61

The Chairman treated the letters and telegrams from carriers more formally, when they sought a formal Commission order. Here, as we

60. Sec. 16, 24 Stat. 385 (1877). The Commission's findings were "prima facie evidence of the matters therein stated" in the enforcing court.
61. Chairman Cooley wrote in his diary on August 12, 1887, "I have sent off a great batch of letters today in answer to inquiries & complaints in railroad matters." On August 15, he sent a rather lengthy letter describing the "powers and procedure of the Commission" in which he used "letter" and "complaint" virtually interchangeably, or brought them together in the phrase "complaining letters." He notes that the Commission ideally needs and requires that "complaints be verified in proof of genuineness and good faith, and that they recite sufficient of the facts to make out an apparent case of injustice;" upon filing, such a document then becomes a "formal complaint." 1 I.C.R. 408, 409 (1887).
noted earlier, he insisted that the carriers file verified petitions. He continually encouraged the carriers in doubtful cases to assume that they were subject to the requirements of the new statute.

The Commission adopted its first Rules of Practice on May 25, 1887, or 55 days after its organization.62 These rules governed the procedure to be followed on the filing of formal petitions and complaints seeking formal Commission action. Petitions seeking relief from Section 4 had to be verified. Complaints also had to be filed in verified form and "briefly state the facts which are claimed to constitute a violation of the Act." The rules then essentially followed the path prescribed by the statute, namely, that the Commission would cause a copy of the complaint to be served upon each common carrier complained against, such carrier would have to file a verified answer within 20 days (or less if the Commission ordered a shorter period for answer), and, if the complaint remained unsatisfied, the Commission would hold a hearing. However, as the Commission stated in its Second Annual Report, "The great majority of complaints . . . have been laid before the Commission informally,"63 that is, outside the hearing process and only in an exchange of correspondence with the Commission's serving essentially as a mediator.64

The correspondence was substantial in the early months and physically exhausted the commissioners, particularly the Chairman. His diary contains numerous references to "busy days" or "hard day's work on Commission business."65 On August 17, 1887, he wrote, "I have had two very busy days this week, the correspondence of the Commission, all of which is sent me now, occupying my time to the extent of human endurance. . . . The work of the Commission grows to threatening magnitude."

Chairman Cooley's goal in every case was to obtain a plain statement of the facts from complaining shippers, and through persuasion, seek to obtain redress from the railroads. In his writings of 1883, Cooley had defined the role of a railroad commissioner as a "friendly umpire between the public on the one hand and the railroads on the other."66

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64. Cooley had written in 1874 long prior to the creation of the Commission that there was no need for "a judicial order after hearing for every action of government that touches the right of individual citizens." Weimer v. Bunbury, supra note 40, 30 Mich. 201, 215 (1874).

65. See, e.g., COOLEY DIARY, supra note 5, Apr. 4, 1887; Apr. 6, 1887; May 9, 1887 (covering Apr. 13-24); Aug. 17, 1887; and Sept. 10, 1887.

66. Quoted in Jones & Alan, supra note 10, at 610.
His guiding principle was "equality of rights, privileges, and capacities." Consequently, he could report in the First Annual Report, that complaints against carriers were "made as informal as should be consistent with order and regularity" and essentially in the form of a verified petition that set forth the facts:

In no case has the Commission declined to given attention to a complaint because of its being informal or imperfectly presented; but when not in shape for its action, if the facts indicated a probable grievance, it has opened correspondence with the carrier with a view to redress. In the majority of cases the correspondence has resulted in satisfactory arrangement.

The Chairman concluded, that, even when hearings were held:

It is a pleasure to note that in this informal mode of procedure the parties have in general most heartily co-operated, and that they have been very liberal in agreeing upon the facts when it is practicable to do so, thereby materially shortening the hearings and making them assume more the form of amicable contentions.

By the beginning of December, 1887, the Commission had docketed only 103 formal complaints.

The Commission, as noted above, did not dismiss complaints for reasons of improper form or incompleteness, but rather wrote to complainants requesting them to correct deficiencies or to supply further information. On the other hand, dismissal was the proper course, when the complaint both "failed to state clearly any facts upon which we can intelligently [sic] act, or to present a case within our jurisdiction," or if a railroad's petition did not set forth sufficient facts "for the purposes of an intelligent judgment upon the situation."

So far we have not discussed very many limitations on the official disposition of informal correspondence. It reviewed all correspondence and forwarded informal complaints that made a prima facie case of unfitness to the railroads. One limitation that it did follow was that it would not itself decide the lawfulness of a particular rate in the form of a hypothetical case contained in informal correspondence. Chairman Cooley explained:

it is not the province of the Commission to express opinions generally as to what railroad companies may or may not do, or to be advisers for them in matters of statutory construction. The Commission deals only with practical questions, & undertakes to settle only actual controversies. Opinions upon

67. See, e.g., T. Cooley, Constitutional Limitations, 393 (1883).
69. Id. at 112, reprinted in Report of the Secretary of the Interior, 1887, at 1182.
70. See Cooley to Fusz, Apr. 19, 1887, LETTER BOOK, supra note 17, at 197. The same rule applied to railroads. See Cooley to Anderson, Apr. 16, 1887, Id. at 143-44, if the petition is unverified, "it would be necessary to return it for that important formality."
71. Walker letter of Apr. 18, 1887, Id. at 172.
72. Cooley to Anderson, supra note 71.
abstract questions would be without authority, & for that reason if for no other should not be officially given. But it is always possible, also, that they may never become practical questions, or if they do, that they will assume such shape and be attended by such circumstances as to make previous views inapplicable and misleading.  

The Commission, therefore, consistently refused to decide issues relating to the lawfulness of particular rates that "'the railroad companies shall or shall not make to any class or organization of persons'" in advance of the carriers' having filed such rates; it would entertain only "'actual controversies when the rates actually made are suffered by the parties.'"  

Commissioner Schoonmaker took a somewhat different tack on hypothetical questions, but with the same result. He advised a school president, who had requested information regarding the reduced rates allowable to students:

The responsibility should be taken in the first instance by the Railroad Companies and then if complaint be made this Commission can pass upon it but it can not give opinions that are truly abstract.

The commissioners also avoided expressing informal opinions, if they believed that the question might later arise in a more formal setting and they might then be asked for a formal opinion. Some questions "'[c]ould not properly be answered by the Commission on ex parte presentation. They are questions which might become the subject of lawsuits.'"  

The Commission strictly applied the rule calling for formal petitions for relief from Section 4 of the Act. The petition for such relief was expected to contain "'the material facts connected with your application, and the precise relief or decision desired, verified by your affidavit.'" Chairman Cooley continually insisted that an application "'should be presented

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73. Cooley to DeLever, Apr. 1, 1887, LETTER BOOK, supra note 17, at 5-6; see also Cooley to Aglar, Apr. 4, 1887, id. at 19; Cooley to Hall, Apr. 4, 1887, id. at 28; Cooley to Smith, Apr. 14, 1887, id. at 70; Cooley to Todd, Apr. 14, 1887, id. at 75; Cooley to Harte, Apr. 14, 1887, id. at 91, "'legal question ... might become the subject of a suit or of a formal proceeding;'' Cooley to Kercher, Apr. 14, 1887, id. at 102, "'would be binding on no one.'"

74. Cooley to Henderson, Apr. 14, 1887, id. at 77, 1 L.C.R. 18 (1887); Cooley to Fulton, Apr. 10, 1887, id. at 139; and see Cooley to Belknap, Apr. 15, 1887, id. at 134, "'The railroad companies should determine their policy for themselves.'"

75. Schoonmaker to Mollison, Apr. 7, 1887, id. at 60.

76. Schoonmaker to Patrick, Apr. 6, 1887, id. at 51, "'The Commisson cannot express opinions in advance upon questions that may come before it for determination.'"

77. Cooley to McDonald, Apr. 14, 1887, id. at 71.

78. Special rule adopted April 2 and Rule No. 2 adopted May 25.

79. Walker to Sargent, Grand Master, Bro.of Locom.Firemen, Apr. 6, 1887, LETTER BOOK, supra note 17, at 49.
by verified petition,"\textsuperscript{80} even when Leland Stanford, president of the Southern Pacific, urgently requested such an order.\textsuperscript{81} Cooley repeated that the Commission "still hold that if . . . you call for authoritative action, a case must be formally presented by petition and then investigated by them."\textsuperscript{82} Cooley added in responding to another railroad's request, "This has been required in all Cases, and seems to be essential to the orderly and proper conduct of the business of the Commission."\textsuperscript{83}

Of course, if the railroads were to be heard on their applications for relief from Section 4, the shipper also would be given an opportunity to be heard. The commissioners often volunteered to notify shippers should the railroads they were using apply for Section 4 relief.\textsuperscript{84} And, if unusually high rates were brought to their attention in their consideration of the application for temporary relief, they would bring such matters to the attention of the affected railroad for correction. For example, the wool growers argued that the rates on wool from local stations in Oregon and elsewhere were much higher than from major shipping points like Portland; Chairman Cooley wrote the affected railroad, that the Commission members,

suggest the propriety of your at once endeavoring to come to an understanding with the wool growers in respect to this business, or arranging for a hearing upon the subject before the Commission at an early day, and before the expiration of the seventy-five days names in the temporary order. . . .\textsuperscript{85}

The Commission insured the widest possible notice to shippers of its proceedings involving Section 4 by ordering the railroads, 1) to publish notice of the petition in two newspapers of general circulation before filing the petition with the Commission, and 2) after filing, to post copies of orders granting temporary relief, which also established hearing schedules, with the tariffs at all stations.\textsuperscript{86} The posting requirement was an innovative use of an implied power to condition an order granting temporary relief from Section 4 ("it is a condition of this order"); and it reflected an intent to notify the entire shipping community using the line and to encourage the widest possible participation in its proceedings, a matter it further encouraged by scheduling several of its hearings outside Washington.

\textsuperscript{80} Cooley to Winter, Apr. 1, 1887, \textit{id.} at 8; \textit{and see Schoonmaker to Spring, Apr. 15, 1887, id. at 130.}

\textsuperscript{81} See exchange of telegrams and correspondence, Apr. 4-7, 1887, \textit{1 I.C.R. 16-17} (1887), reprinted in \textit{RAILWAY AGE}, supra note 7, Apr. 15, 1887, at 267.

\textsuperscript{82} Cooley to Stanford, Apr. 7, 1887, \textit{LETTER BOOK}, supra note 17, at 55. \textit{1 I.C.R.} 17 (1887).

\textsuperscript{83} Cooley to Anderson, Apr. 5, 1887, \textit{LETTER BOOK}, supra note 17, at 36.

\textsuperscript{84} Cooley to Fulton, Apr. 1, 1887, \textit{id.} at 1; Cooley to Hall, Apr. 7, 1887, \textit{id.} at 56.


\textsuperscript{86} See, \textit{e.g.}, Re Southern Ry. & S.S. Ass'n., \textit{1 I.C.R.} 15, 16 (1887); Re Transcontinental Roads, \textit{1 I.C.R.} 27, 28 (1887); Re Atchison, T. & S.F.R.R. Co., \textit{1 I.C.R.} 58, 60 (1887).
Temporary orders were used solely for "provisional action only, and to give all parties concerned an opportunity for as early a hearing as may be practicable." Mosely assured one shipper at the direction of the Commission, that temporary orders . . . are not to be considered as indicating the result which the Commission may arrive at from more serious deliberations. A temporary order in the meantime would "prevent derangement of business" of the railroad, while the hearings occurred.

The Commission issued very narrowly drawn temporary Section 4 orders. They applied only to the railroads making applications for them, and then only to the specific traffic described in the individual applications rather than to all the applicants' traffic. And temporary relief was not automatically given simply for the asking; Commissioner Walker explained to one railroad:

'[Y]ou do not show in your petitions, or prove by evidence, any pressing exigency or imperative urgency for a temporary order, such as has been shown in the not very numerous cases in which such orders have been made. They have been withheld in other instances upon that ground.'

The Commission's evidentiary rules, like its rules of practice and procedure, departed from the judicial norm of the day. Chairman Cooley wrote that the Commission at its hearings outside Washington "will not care to take proofs in any formal way." The Commission accepted opinion evidence from railroad officials, "but the Commission ought to be able to see from the petition itself that it is so," whether or not the opinion be well-founded.

5. ASPECTS OF JURISDICTION

Acting like a court, but without judicial precedent, the Commission thought it best to avoid too early a construction of its own role in the scheme of things. It described its jurisdiction whenever an issue was formally presented, but it would not go out of its way to answer hypothetical

87. Cooley to S.Bernheimer & Sons, Apr. 6, 1887, LETTER BOOK, supra note 17, at 42; see also Cooley to Proctor & Gamble, Apr. 14, 1887, id. at 72; Moseley to Donohue, May 19, 1887, id. at 77.
88. Moseley to Fell, May 19, 1887, id. at 90.
89. Cooley to Firth, Apr. 6, 1887, id. at 46.
90. Rule No. 2 of the I.C.C. Rules of Practice, 1 I.C.R. 841 (1887); Bragg to Knapp, Apr. 7, 1887, LETTER BOOK, supra note 17, at 67; Cooley to Axtell, Apr. 16, 1887, id. at 145-46.
91. Walker to Clarke, Apr. 23, 1887, id. at 255-56. See also Cooley to Anderson, supra note 71; Cooley to Axtell, supra note 91; Walker to Aiken, Apr. 18, 1887, LETTER BOOK, supra note 17, at 149. In the last letter, Walker helpfully added that, "It would seem from your statements," that the Section 4 order on behalf of the Southern Railway and Steamship Association "applies to all your inter-state business."
92. Cooley to Johnson, Apr. 14, 1887, id. at 79; see also Cooley to Anderson, supra note 71 and Cooley to Axtell, supra note 91.
inquiries. On the other hand, on numerous occasions, the Commission’s Letter Book reflects a conscious effort to define jurisdiction, particularly vis-a-vis the court system, and to provide guidance to the public regarding these questions.

Chairman Cooley led the way on this hesitant approach to jurisdictional questions, but he did not act alone. He first consulted his colleagues. For example, on the first day of conducting public business, the Chairman advised one correspondent that he had laid his inquiry “before the members of the Commission,” and that they had decided that no opinion could be expressed, since the “questions which are presented by it seem to be questions rather for the Courts than for the Commission.”

The commissioners typically advised an interstate railroad, when it inquired whether it was subject to the Commission’s jurisdiction, that the Commission would “assume” the carrier was subject to the new act and that it should file appropriate rates. These were tentative views subject to later revision. Thus, the Commission advised the independent express companies to file rates until a hearing could be held on the jurisdictional question of whether such companies were subject to the new Act. After hearing, the Commission held that the independent express companies were not subject to its jurisdiction.

The Commission drew a jurisdictional line, as we noted earlier, be-

93. Cooley to McDonald Bros., Apr. 1, 1887, LETTER BOOK, supra note 17, at 3.
94. See Walker to Falkenbach, Apr. 7, 1887, id. at 59; Cooley to Achevy, Apr. 14, 1887, id. at 100. The commissioners might advise, that “[t]he foregoing are our general views, of the first impression, upon the questions presented in your letter. The matter will be more formally considered if you should see fit to present a verified petition.” Walker to Germond, supra note 25.
95. Cooley to Chany, Apr. 4, 1887, LETTER BOOK, supra note 17, at 25, “until such hearing is applied for, the Commission will assume that the law does apply to such companies;” Schoonmaker to Smith, Apr. 5, 1887, id. at 37, “until a hearing upon the question it will be assumed that the law applies to Express Companies.”
96. Re Express Companies, 1 I.C.C. 677 (1887). The Hepburn Act, ch. 3591, 34 Stat. 584 (1906), amended the Act to Regulate Commerce to include express companies within the carri-
between deciding cases and dictating specific rates that the railroads must charge in advance of publication. It would not assume any jurisdiction to authorize discounts or other concessions in freight rates to individuals, when freight agents requested it to authorize such concessions; 97 and it would not decide whether particular persons or classes of persons were entitled to free or reduced rate transportation under Section 22 of the Act. Here the Commission thought it best to have such questions decided initially by the railroads and to await any complaints resulting from particular decisions. At the same time, it assured correspondents that no penalties would be assessed against a railroad that made such decisions for itself: "Penalties are for wilfull or reckless disregard of law; not for errors of judgment." 98

The Commission departed from its hands-off role under Section 22 in some cases. For example, it typically responded to inquiries about religious ministers and teachers that railroads had a "right" to grant reduced rates and special privileges to such persons. 99 Commissioner Schoonmaker rather weakly explained that this advice was given, since in his view such persons "cannot conveniently be represented before this Commission." 100

In one case, the Commission greatly narrowed the scope of Section 22 so as to preserve a broad jurisdiction over rail passenger fares. Section 22 then provided "that nothing in this Act shall apply to the issuance of mileage, excursion, or commutation passenger tickets." A railroad argued that the section, therefore, excluded all such tickets from the discrimination provisions of the statute, and thus allowed it to grant special rates or privileges to any class of persons, such as traveling salesmen ("commercial travelers"). Commissioner Morrison writing for the Commission, after "he had changed his mind 17 times about it," 101 dictated an opinion one Sunday to a stenographer, that the exclusion applied only

97. E.g., Cooley to Finley, May 16, 1887, LETTER BOOK, supra note 17, at 471.
98. Cooley to Harrison, Apr. 18, 1887, Id. at 163; see also Cooley to Bedell, Apr. 17, 1887, Id. at 93; Schoonmaker to Wheeler, Apr. 23, 1887, Id. at 281.
99. Cooley to Bishop Knickerbocker, Apr. 18, 1887, Id. at 157, 1 I.C.R. 21 (1887); see also RAILWAY AGE, supra note 7, Apr. 22, 1887, at 282-83; Cooley to Bishop Gillespie, Apr. 19, 1887, LETTER BOOK, supra note 17, at 190.
100. Schoonmaker to Rev. Hasselquins, Apr. 23, 1887, Id. at 285-86. Schoonmaker even expanded the definition of "minister" in response to another inquiry: "There is no doubt of the right of the Railroad Companies to grant special rates to Ministers of religion and in deciding in good faith that Missionaries are ministers of religion. . . ." Schoonmaker to DeGruff, Apr. 16, 1887, Id. at 169-70; see also Schoonmaker to Wheeler, supra note 99, at 280-81.
101. COOLEY DIARY, supra note 5, July 19, 1887. Morrison wrote the opinion after Cooley had encouraged him to sit down and write; Cooley then pronounced the opinion "a very good one."
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to the "issuance" of such tickets but not otherwise. He thereby avoided the carrier's construction of the section, which in effect would have exempted from the reasonableness and discrimination sections "all that relates to passengers."

The Commission also typically construed the statute informally at the request of other government officials. For example, the Commission advised the Michigan Commissioner of Railroads that the carriers may grant free passes to State railroad commissioners. It also advised the Secretary of the Interior whether government contractors qualified for reduced rates under Section 22 in "deference to a department of the government."

The letter from General Black, Commissioner of Pensions, placed the Commission in a quandary. He asked whether the railroads could legally continue to afford half fares to disabled volunteer soldiers traveling from one national home to another. The letter raised an issue clearly outside Section 22, but it originated from a government official. Chairman Cooley responded that the construction of the statute was a "judicial act, involved in the decision of some controverted question," which required the filing of a complaint. However, he added, "If the fair meaning of the second section" of the Act was that the giving of a half-rate is "the allowance of special rate . . . for certain persons, not common to all . . . then such allowance would be unjust discrimination, otherwise not." We can assume that the General understood the import of the Chairman's message.

The commissioners advised its correspondents when it clearly had


It is true that the Commission was perhaps less "sensitive" in this early period to passenger fares than to freight rates as the Hoogenbooms assert. See Hoogenboom, A HISTORY OF THE ICC, supra note 19, at 24. There were no large sums of money involved, when passenger problems were treated case-by-case, and passenger fares would interfere with the case-by-case learning process involving the commerce of the country. It is ironic that a company-wide solution to unreasonable passenger fares (resulting in the creation of a Riders' Fund on the company's books) should come years later in the courts, not in any agency; relate to local, not interstate, transportation; and be approved while private ownership of public surface transportation steadily declined throughout the country. See Bebchick v. Public Utilities Commission, 318 F.2d 187, 203-204 (D.C. Cir. 1963), cert. denied, 373 U.S. 913.

103. Bragg to Rich, Apr. 14, 1887, LETTER BOOK, supra note 17, at 92; but see Cooley to Kercher, Mayor of Nashville, Apr. 14, 1887, id. at 102, refusing an informal opinion.

104. Cooley to Muldrow, Acting Sect'y of the Interior, Apr. 18, 1887, id. at 151-53, 1 I.C.R. 23 (1887). See also RAILWAY AGE, supra note 7, Apr. 22, 1887, at 283; Schoonmaker to Baird, U.S. Comm'r of Fish & Fisheries, Apr. 19, 1887, LETTER BOOK, supra note 17, at 208-12, 1 I.C.R. 23 (1887).

105. Re Inmates of National Homes, 1 I.C.R. 75 (1887), see RAILWAY AGE, supra note 7, May 27, 1887, at 371.
no jurisdiction; one party even asked the Commission whether a particular State had the power to tax the railroad.\footnote{106} More often, the Commission would respond to general jurisdictional inquiries, that it would not "answer questions of construction under the Inter-State Commerce Law except when they are so presented that its decision would be authoritative."\footnote{107} Or, they might add, the "question you raise is a suitable one to submit to counsel, but we do not deem it proper for us to express an opinion upon it."\footnote{108}

**CONCLUSION**

Under Chairman Cooley's guidance, the Commission in the beginning period of its life under the Act to Regulate Commerce firmly established simplified procedures and an informal complaint practice. A century later those traditions still form a basic characteristic of the Commission's procedure and practice, and a standard for other agencies and the courts as well.

The long and short haul clause of Section 4 was itself worthy of full-time effort in this period; but the Commission also began a program of reviewing the rates charged to individual shippers or classes of shippers, and marking out the bounds of the exemptions from the Act. It deftly used the threat of a hearing as much as the hearing process itself to bring about needed changes in railroad rates and to reduce the large scale discriminations that characterized the rate structure.

The first commissioners were politically astute, principled, and best of all unafraid to administer the new Act in the public interest. Their strong self-image can be illustrated: in the fall of 1887 the Chicago Tribune, as Cooley recorded in his diary, had been saying "ugly things about the Commission and calling its members weak and wanting in proper independence." When the Railway Editor called on him, Cooley asked "what

\footnote{106} Cooley to Littlefield, Apr. 16, 1887, LETTER BOOK, supra note 17, at 135. See also Cooley to Crawford & Dallas, Apr. 6, 1887, id. at 43, no jurisdiction over canal companies; Bragg to Seag, Apr. 6, 1887, id. at 48, no jurisdiction over a boat line in Rome, GA; Cooley to Greenleaf, Apr. 14, 1887, id. at 99; Cooley to Anderson, Apr. 15, 1887, id. at 124, no jurisdiction in "looking up lost freight or collecting damages therefor."

\footnote{107} Cooley to Blaisdell, Apr. 14, 1887, id. at 98; see also Cooley to Winter, Apr. 2, 1887, id. at 12, "controversies . . . which present practical questions upon which it has authority to pass definitively;" Cooley to Johnston, Apr. 2, 1887, id. at 13, "actual controversy for authoritative decision." Chairman Cooley advised one correspondent that the Commission had no general power to prescribe freight classifications, adding the hopeful note that "it might perhaps deal with cases of manifest injustice when formal complaint was made." Cooley to Hunter, May 14, 1887, id. at 455.

\footnote{108} Cooley to Ferguson, Apr. 6, 1887, id. at 47; see also Schoonmaker to Spring, Apr. 6, 1887, id. at 50; Cooley to Moyer, Apr. 14, 1887, id. at 82; Cooley to Waterbury, Apr. 14, 1887, id. at 86; Cooley to Pratt, Apr. 14, 1887, id. at 88; Cooley to Potter & Marsden, Apr. 15, 1887, id. at 112.
he meant by that kind of talk” because that editor “knew perfectly well the Commission was fearless.”

This is not to say that the Chairman did not hope for greater accomplishment. As Chairman Cooley settled into his new office, he expanded his vision of what the Commission might accomplish. He had written several years earlier, that:

Different principles are applicable in different cases, and require different forms and proceedings; in some they must be judicial; in others the government may interfere directly, and ex parte. . . .

Unhappily, he grew overworked and progressively weaker, and could not serve out his full term; as he grew more weary, he also grew more disenchanted with the Commission limiting its role to the decision of cases and failing to act more directly. He derisively characterized the Commission in a momentary pique as a “police court” in his diary, not that it was exercising excessive police power, but because it was continuously in session to hear controversies—often minor ones at that—from whatever parties crossed its threshold. It was neglecting more important work, which Cooley considered “the gradual education of the public in the matter of railway transportation” and “the quiet work we can perform in the improvement of the law and the unification of a railway system.” Thus, he wrote in 1889:

The effect of overwork was aggravated by a consciousness that the view taken of our duty under the law by my associates was different from mine: their view I must take the liberty of characterizing as narrow; as a police court view; a view which makes our principal duty the hearing of complaints, while I thought the passing upon complaints of far less importance than the gradual education of the public in the matter of railway transportation, the quiet work we can perform in the improvement of the law and the unification of a railway system.

Such education would lead to more sophisticated complaints, and hence to more effective regulation. Chairman Cooley had moved in the direction of a more active Commission during the Burlington strike of 1888; but the Commission was reluctant to move with him.

I believe Cooley underestimated what he and his colleagues had ac-

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109. Cooley Diary, supra note 5, Sept. 22, 1887. The Editor took refuge in the claim, that as a newspaperman he had to make his paper “interesting.”

110. Supra note 39.

111. Prof. Jones, an otherwise acute student of Cooley and his historical period, misinterprets Cooley’s terse remark in his diary. Jones errs, when he juxtaposes Cooley’s suggestion for “less coercive power” by the Commission and his characterization of the Commission as a “police court,” which are independent thoughts and in different documents. See Cooley and the Interstate Commerce Commission, supra note 10, at 615.

112. Cooley Diary, supra note 5, Sept. 19, 1889.

113. See, e.g., supra note 34.

114. See Cooley and the Interstate Commerce Commission, supra note 10, at 616 et seq.
accomplished. I have mentioned a few of these accomplishments. More important than those, however, is a legacy of integrity from this early period that each Commission since then, and indeed each of the other independent agencies that were spun from its image, has drawn sustenance. Noted earlier was Judge Friendly’s references to the clarity and probity of the principles laid down in the earliest Section 4 decisions. Beyond that lies a vision of public service, conservative in the best sense, that pervaded their work when they came to Washington. The philosophy underlying their approach to national office was best summed up by Chairman Cooley in an address he entitled, “The Lawyer’s Duty to the State.” He spoke words then that now seem so timely:

The State, as a political organism is for the time, in a measure, committed to our charge for conservation, and if need be, renovation. The State is not for us to live upon, prey upon, grow wealthy and great upon, but it is to be passed along tenderly and lovingly, and the better for the handling.  

Then, dismissing those who would look back to all that was once “pure and good,” he concluded that “the golden age should always be in the future, because in the order of Providence we are put here to make the future better than the past.”

THE INTERSTATE COMMERCE COMMISSION  
CENTENNIAL PROCEEDINGS  
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MS. GRADISON: Ladies and gentlemen, please take your seats. The hearing is about to come to order.

Honored guests, fellow Commissioners, former Commissioners, and former and current employees of the Interstate Commerce Commission, ladies and gentlemen, it is a high honor and a personal privilege that I welcome each of you to the Interstate Commerce Commission’s Centennial Planning Committee celebration of the Interstate Commerce Commission’s one hundredth anniversary.

I thank you for coming here today. I would especially like to extend my appreciation to Fritz Kahn and the ICC’s Centennial Planning Committee for making this celebration possible.

It was more than a year ago when Mr. Kahn discussed with me the idea that comes to fruition in today’s program and this evening’s banquet. A lot of hard work was devoted in arranging these festivities, and we are all indebted to you, Fritz and the committee for putting this celebration together.

One hundred years ago, on March 31, 1887, five newly appointed government officials visited the White House to be greeted by President Grover Cleveland. These gentlemen were the first five members of the Interstate Commerce Commission, and they included Thomas N. Cooley of Michigan, who was selected by his colleagues as the Commission’s

* Chairman, Interstate Commerce Commission
first Chairman; William R. Morrison of Illinois; Augustus Schumacher of New York; Aldus F. Walker of Vermont; and Walter L. Bragg of Alabama.

The following day, April 1, 1887, in its first business session, the Commission entered its first order approving an application for several railroads to charge less for a longer haul than a short haul. Thus, the regulation of interstate transportation began.

These original Commissioners could not have foreseen what would evolve in the years ahead. New forms of transportation companies would emerge, a body of administrative transportation law would develop, and regulation would take many twists and turns.

A review of the topics on today’s program suggest comprehensive coverage of regulation, administrative law, and of the Commission as an institution. My topic is the people behind the system.

Without the cooperation, involvement, and dedicated service of the people, the institutional story of the Commission that you will hear today would not have been possible.

Certainly, the transportation industry as a whole, their associations, and their representatives deserve to be applauded for the presentation of formal views and positions throughout the years in matters before the Commission. Without the industry’s confidence and active participation in the process, the Commission could not carry out its Congressional mandate and administer the Interstate Commerce Act.

Shippers and receivers of freight, their associations and representatives deserve similar accolades for their contributions and participation in matters before the Commission. The administrative process can only function with the diverse and crucially needed views of the shippers and their supporters serving as part of the record.

The same applies to participation of other agencies, individual states, consumer groups, local governments, and private citizens.

The members of the Commission Bar and all who practice before the agency also deserve to be saluted on this momentous occasion for dedication in representing their clients’ interests and in maintaining the highest standards of ethics required by the legal profession and by the Commission.

Since the original five members organized the Commission in 1887, ninety-one Commissioners have followed in their footsteps. Their function is the heart of the system — decisionmaking. The Commissioners’ right to vote is an awesome responsibility that must be exercised with intelligence and fairness, taking into account the evidence of the record and the applicable laws.

Indeed, the nation has been fortunate that the Commissioners selected by the President and approved by the Senate throughout the his-
tory of the Commission have served with distinction, upholding the highest standards of performance required of the position.

We have with us today five sitting Commissioners and twenty former Commissioners. I hope you will join me in expressing appreciation to these Commissioners, as well as all those who are not here with us today, for their outstanding service to the public as members of the agency.

Finally, I would like to recognize a special group of people, the Commission’s employees. This includes employees who spent all or part of their careers with the agency and those who are currently with us.

The Interstate Commerce Commission has fine professional, technical, and support staff that always has had a firm resolve to do quality work and a keen sense of serving the public good. In short, the most important ingredient of the Commission’s operation over the years has been the dedicated public service of its employees.

I will not get into time lags, paperwork, nor the cumbersome system of regulation that has developed over the last hundred years. Our mission today is to review why the agency exists and what has been accomplished through the hundred years. Discussions of whether or not we should continue may be carried out as a result of today’s presentations and exchanges, but we are here today to focus on who we are and what we have done.

So with that, I would like to announce or introduce another dedicated government employee, our keynote speaker, the Honorable James C. Miller, III.

He is Director of the Office of Management and Budget. He is a native of Conyers, Georgia. He received an undergraduate degree in economics from the University of Georgia and a doctorate in economics from the University of Virginia.

He taught economics at Georgia State University and Texas A & M and served as Senior Staff Economist at the United States Department of Transportation, Senior Staff Economist for the President’s Council of Economic Advisers, and Assistant Director of the United States Council on Wage and Price Stability.

Mr. Miller was a resident scholar at the American Enterprise Institute and Co-Director of AEI’s Center for the Study of Government Regulation, Administrator for Information and Regulatory Affairs. He was Executive Director of the Presidential Task Force on Regulatory Relief, and before assuming his present position in October of 1985, Chairman of the Federal Trade Commission.

Ladies and gentlemen, it is with great pleasure that I introduce to you one of President Reagan’s closest advisers, the Honorable James C. Miller, III.
MR. MILLER: My appearing here today reminds me of the fellow who gave a particularly well-received speech and was paid many compliments afterwards. One well-wisher, an elderly lady who was prone to excitement, declared, "That was the most superfluous speech I ever heard!"

The speaker, being brought up to mind his manners, replied, "Why thank you, Ma'am. Maybe I should have it published posthumously."

To which she said, "Oh, by all means! In fact, the sooner the better!"

I tell this story, because I hope what I have to say on this occasion will be significant rather than superfluous. I am, as many of you know, a rather odd choice to be keynote speaker at the ICC's centennial birthday bash. If I am not the Grinch who stole Christmas, I am at least the Grouch — the curmudgeonly economics professor — who would have preferred that the ICC had long since gone to that Great Administrative Hearing in the Sky.

It was therefore very gracious of you to invite me, and I would like to be a good guest. I hope I can deliver my message today without dampening the festivities.

The Interstate Commerce Commission is, of course, the federal government's oldest independent regulatory agency. Established in 1887, it became the prototype for the agencies that followed. And, in many ways, its story is the most romantic of them all.

* Director, Office of Management and Budget
The ICC is one of the earliest instances we can point to where the federal government intervened directly in the economy to protect the economically weak from the economically strong. As most history books tell the tale, the ICC was created to save America’s farmers from discriminatory and oppressive rate structures imposed on them by the great railroad monopolies. It is a dramatic episode that inspired writers of fiction as well as historians.

Some of you may have heard of Frank Norris’ classic muckraking novel, *The Octopus*, in which Norris championed the California wheat-growers against the mighty Southern Pacific Railroad. In an unforgettable scene from that novel, a farmer who is being overcharged outrageously for shipment of some new plows turns to a railroad executive and storms:

What next? My God, why don’t you break into our houses at night? Why don’t you steal the watch out of my pocket, steal the horses out of harness, hold us up with a shotgun? Yes, stand and deliver, your money or your life.

Such were the authentic passions that gave birth to the ICC. And it was not just the farmers who were complaining. Shippers, small merchants, passengers, and others all had their respective grievances. So Congress was moved to act.

The only trouble with this version of the story is that it posits an enlightened and liberal government stepping in to curb the depredations of greedy and unprincipled monopolists. It suggests that the free market, which ought to have prevented — or at least moderated — these abuses through vigorous competition had somehow failed in its duty.

But this is not what, in fact, happened.

Yes, there were railroad monopolies in those days — more on that in just a minute — and yes, they were guilty of forcing discriminatory and often unfairly high rate structures on many segments of the public. But these monopolies were created by more government action rather than market inaction. Moreover, the strongest demands for government intervention came from the railroads themselves — who sought protection from the forces of competition.

In the second half of the Nineteenth Century, it was widely recognized that extending railroad lines would tie the country together and generally increase prosperity. So government at all levels — local, state, and national — offered incentives and lavish subsidies to the railroads to expand. Loans, guarantees, bond issues, and land grants to railroads were common. The cost advantage over possible competitors, plus the obvious economies of scale characterizing the technology, made these commercial enterprises formidable indeed.

What followed was predictable. Railroad companies engaged in discriminatory pricing — they overcharged wherever they could exert mo-
nopoly power. There ensued a public outcry against these abuses. In areas where railroads competed, price wars were common, despite the best efforts of railroad owners to cartelize the industry and bring such practices to an end. Aware that it would become more and more difficult to suppress competitive forces in the future, and faced with incipient regulatory activity at the state level, the railroad magnates finally cast their lot with the notion of a benevolent Washington regulator which would grant shippers some "rights," but would also preempt the "excesses" of state regulators, and bring some sense of "order" out of "competitive chaos."

And that's how railroad monopolies emerged — as the unintended consequence of government's good intentions. But this was not the end of the story, because economic regulation by government invariably produces economic consequences of its own. In other words, a government regulator does not always behave as its initial supporters envisioned.

Most Americans take it for granted that if there is too little competition in a given sector of our economy, the government must step in to protect consumers from price-gouging and other monopolistic evils. Until fairly recently, however, few Americans considered the other side of this particular coin; namely, that if competition increases in a regulated sphere of the economy, government ought to withdraw and let consumers enjoy the lower prices and better services that are the hallmarks of the free market. In other words, we should deregulate.

The problem is that regulation, once established, is very difficult to curtail or eliminate. A regulatory agency becomes a fact of life for the industries it supervises. Many industries grow comfortable within a regulated environment, and, after a while, even if they opposed it initially, they come to prefer it to the risks, uncertainties, and demands of genuine competition. Worse yet, they become adept at using the rules and procedures of the regulatory agency to forestall potential competitors.

This well-known phenomenon was wonderfully described several years ago by the late Senator James B. Allen of Alabama:

Truckers, major airlines, drug companies, and other highly regulated lines of industries, though they may be lithe and snarling when captured, appear to grow fat and sluggish in their federal cages.

It is easy to forget the competitive jungle where you belong if you are forced to learn to jump through hoops, let your trainer stick his head in your mouth, and submit to similar experiences.

But you can take comfort in the realization that cages also can be used to prevent your natural enemies from coming in. And if, as you grow old with the man holding the whip, you find that he considers your relationship with him his most valuable asset, it can get downright cozy.

So it was with the railroads and the ICC, despite all good intentions to the contrary. The Interstate Commerce Act of 1887 was amended three
times in the ensuing 25 years, giving the ICC greater powers — including authority to fix railroad rates. The regulatory legislation, the Transportation Act of 1920, was expressly intended to increase the profitability of the railroads, as it instructed the ICC to assure that the railroads earned a "fair" return on their investment. The Act of 1920 also gave the ICC control over exit and abandonment; in essence, it gave the ICC the power to force the railroads to cross-subsidize money—losing rail services with revenues from those lines that made money.

Railroads pushed for regulation not only of their own industry but also of the trucking industry — which emerged as a serious rival during the 1920s — and inland water carriers to protect themselves from rate competition during the Great Depression. Congress enacted the Motor Carrier Act in 1935 and brought inland water carriers under the federal umbrella in 1940.

Regulation of the motor and water carrier industries reflected not just pressure from the railroads, but the precarious state of the national economy. Regulation increasingly was accepted as the best way of coping with the economic dislocations caused by the Depression. The ghost of the New Deal was to haunt transportation until late in the last decade.

Gradually, however, the shortcomings of this regulatory approach became obvious to all. Regulation constricts economic growth when price controls do not allow an industry to price its goods or services to reflect costs. Route, entry, and exit controls do not allow an industry to develop new or lower-cost service configurations in response to consumer demand. The result is an industry that is slow to introduce new service or to improve existing service.

Let’s return to the railroads. Until the late 1970s, the government regulated virtually all railroad activity: entry, exit, services, safety, mergers, abandonments, and issuance of securities. And what happened to the industry between the New Deal and the end of the last decade? Railroads’ share of freight traffic fell from 80 percent in 1925 to 35.8 percent in 1979. Class I railroads earned an average of 1.8 percent on equity in 1976 — less than they earned during the Depression. The loss of earnings made it impossible to maintain quality of service, which in turn made it harder for railroads to keep existing customers and attract new ones. Eight railroad bankruptcies, affecting almost a quarter of the railroad system, occurred between 1967 and 1973.

Meanwhile, regulation was hurting the motor carriers as well. Archaic rules forced truckers to take circuitous routes, needlessly restricted the types of freight they could haul, and often barred them from taking on new cargoes at their points of destination — many had to return home empty. These costly and wasteful practices were reinforced by entry restrictions that barred potential competitors. Freight rates were maintained at artifi-
cially high levels, and a lot of gasoline was burned for no good purpose during a time of grave energy shortages.

Accordingly, along about the mid-1970s, another "reform" movement began — a movement aimed at deregulation, rather than regulation. In the 10 years between 1976 and 1986, there was a major reversal in transportation policy. The Railroad Revitalization and Regulatory Reform Act (1976), the amendments to the Federal Aviation Act deregulating air cargo (1977), the Airline Deregulation Act (1978), the Motor Carrier Reform Act (1980), the Staggers Rail Act (1980), the Household Goods Transportation Act (1980), and the Surface Freight Forwarder Deregulation Act (1986) all reduced or removed regulations and made more room for competition in transportation markets. This legislation was the result of bipartisan support and broad-based public coalitions, and it is eloquent evidence of how much prevailing opinions have changed in recent years.

This legislation is also eloquent evidence of how public-spirited regulators can bring about needed changes — even though such changes arguably were not in the personal interests of those involved. I have little doubt that deregulation would have won out in the end. It was an idea whose time had come. But think of the outstanding services in bringing about a Congressional commitment to deregulation, and in managing the deregulatory process, performed by Dan O'Neal, Darius Gaskins, Reese Taylor, and Heather Gradison — just at the ICC!

The Staggers Act freed a substantial portion of railroad traffic from maximum-rate regulation and allowed regulated rates to be adjusted more freely — down as well as up. The Motor Carrier Act increased rate flexibility, relaxed entry and routing restrictions, and opened up the trucking market to new entry: between 1980 and 1984 the number of regulated motor carriers increased 86 percent from 18,000 to 33,548. The savings to the United States economy from these regulatory reforms come to tens of billions of dollars annually.

Now I have no wish to be a party pooper, but it's time to ask the question: do we need the ICC any longer? Railroads and motor carriers have been deregulated to a very significant extent; do we need to spend $46 million a year so the ICC can administer the last vestiges of regulation? For example, the Commission grants between 97 and 99 percent of all permanent applications for trucking authority and processing these applications costs $4 million a year. Is this trip necessary? The Commission spends another $4 million a year processing 1.4 million trucking tariffs — fewer than 100 of which are ever challenged.

Do we still need the ICC? In reply, I quote from the testimony of former ICC Chairman Reese Taylor before the Senate Commerce Committee in 1983:

We are engaged in an absolute sham of regulation for regulation's sake.
It is nothing more than a monumental paper-shuffling operation, and the sooner it ends the better. There is no redeeming public benefit involved. It is absolute nonsense.

There is little left for me to say. The ICC has lived a long and eventful life. It has discharged its Congressional mandate faithfully for 100 years. It has done all the good it can; we can expect no more from it.

Perhaps history one day will describe the ICC as a century bracketed by two Reagans — Texas Congressman Reagan, who helped get the 1887 Act passed, and President Reagan who says we should now move on to a post-ICC era.

Let’s not prolong the Commission’s life by artificial means. Rather, let it die with dignity — and then we’ll get together again for a fantastic wake!

Thank you very much.

MR. R. KAHN: Thank you very much, Jim.

We will move on to the first panel discussion. If Commissioner Minor and his panel will come up front, I will be pleased to introduce the person who will chair today’s activities.

Chairing today’s activities — and I probably should pause before introducing him to remind you that we do have an open house next door, and coffee and Danish will be available most of the morning, tea and cookies will be available in the afternoon.

I should also remind you that largely through the effort of one of our panelists this morning, Bea Aitchison, we have cachets; we have a post office temporarily set up next door in the Interstate Commerce Commission Building, and you can have the stamp appropriately canceled with a first-day, cancellation of the stamp commemorating this anniversary.

I should also note that the activities today were appropriately recognized by the Mayor, and John, do you want to read the proclamation or shall I?

MR. CLEARY: I can do that if you wish.

MR. KAHN: You can read the proclamation. Be sure that you insist that he read to you the Mayor’s proclamation, and with that I will cease and desist, at least for the time being. The best part is yet to come this evening.

The gentleman who will moderate the day’s program is a former President of the Association of, then, the Interstate Commerce Commission Practitioners, someone who frequently over the years has given the Commission a hard time, a partner in the law firm of Donelan, Cleary, Wood & Maser and one of the incorporators of the ICC Centennial Planning Committee, a hard worker who helped to make possible today’s activities, John M. Cleary.
INTRODUCTION OF PANEL MEMBERS

JOHN M. CLEARY

MR. CLEARY: I think everybody who is here or anyone who has had any contact with this rather informal organization of the ICC Centennial Planning Committee recognizes that the kernel of an idea, as Chairman Gradison said earlier, and the leading force behind it all has been Fritz Kahn.

He got some of us together that were thinking this way and got everyone organized. So we have a lot to thank Fritz for today.

Following Mr. Miller, I can recall inviting him to appear before the Practitioners back in 1975, when he was, I believe at that time, on the Council of Economic Advisers in the Ford Administration, and some people thought why should a person of his very firmly held views on regulation be invited to a group that was interested in regulation. I felt it was appropriate to at least hear his views.

Mr. Miller is not here now, but I can say that a year ago, perhaps even today, he had appeared at the Antitrust Section of the American Bar Association, which today is in hearing or in session at the Shoreham Hotel, as it has usually been in the springtime each year. I took the occasion when he was on a panel with Fred Kahn and Judge Scalia to direct a question to Mr. Miller whether or not, in view of the reliance upon competition, it was felt that competition was adequate in all areas of transportation so that some of the regulatory processes need no longer be relied upon.

A year ago, at least, there was a recognition that there are areas of surface transportation in which there exists a certain amount of market power that does not fall consistently within the competitive market, and therefore there might be a need for some continuing overview. I have yet
to hear anyone talk about the total repeal of all phases of the Interstate Commerce Act.

My personal view is that a truly independent administrative agency is far more appropriate, but this is not the day for that battle. This is the day, as Chairman Gradison said, to celebrate what has gone before.

I have been given the responsibility to address this group merely for the purpose of introducing people. So I have already run over my welcome.

It is an honor to see so many of the former Commissioners. I went over to the informal reception in Hearing Room B this morning, even though I have never been employed by the ICC. But I have spent practically my entire legal career in one way or the other related to Interstate Commerce Commission matters.

It was truly a pleasure to go around that room and see people who had been with the Commission, Commissioners returning, and I think one thing I really concluded was the years have done them all very well. I do not know if it was the activities at the Commission or what they have done since, but I think they all just look great, and I am going to add my applause to all of the former Commissioners who are here, including our moderator this morning.

With that, I will introduce the moderator of our first panel. The purpose of this panel is to give us a history of the ICC from some anecdotal ideas with the idea of presenting a good time for all today.

Our moderator for this first panel, who will introduce the other panel members, is Robert W. Minor. Mr. Minor was a Commissioner appointed in 1956 and served until 1958, according to the biographical information I have available.

I think the caliber of the type of Commissioners that this Commission has had over the years is evidenced by the type of person Bob Minor was, and is. He was a graduate of Ohio State in 1940, and in that connection I overheard a few moments ago that, with apologies to Commissioner Bush, I understand that the record should be corrected because Commissioner Minor was in fact the first Commissioner from the State of Ohio, in connection with some of those introductions we heard over in that informal meeting this morning.

He served very distinguishably in the United States Army from 1942 to 1946 as a Lieutenant Colonel and received the Bronze Star and Purple Heart. Then he had the opportunity to return to Ohio State Law School, where he was a summa cum laude, and that is the type of people this Commission has had over the years.

After a career in the railroad industry, he then went into the private practice of law, where he continues the practice in Columbus, Ohio.
And so it is with great pleasure that I introduce former Commissioner Robert W. Minor to moderate this panel.
MR. MINOR: Thank you, and good morning, former colleagues, present members of the staff and of the Commission, distinguished guests, and welcome to the first panel of the day.

As John said, we are going to talk about the history of the ICC, perspectives from the inside.

Fritz Kahn has recruited a distinguished panel of "insiders" to afford a rare view of our subject. Each will have approximately 25 years to cover, and I will introduce each of them in their turn.

Before I do, however, let me share with you a perspective that I am quite sure many of you in this room will recall, for I believe it was in this room 25 years ago, almost to the day, that we celebrated the Commission's 75th birthday, and it was a splendid occasion. We had the Marine Band to play for us. Chairman Pete Murphy was the presiding officer at that time. Speakers included representatives of the industry, Mr. Justice Tom Clark, Senator Warren Magnuson, who was Chairman of what was at that time called the Senate Interstate and Foreign Commerce Committee, Representative Oren Harris, the indefatigable Chairman of the House Committee on Interstate and Foreign Commerce, and United States Court of Appeals Judge E. Barrett Prettyman, who had shortly before been named by President Kennedy to head the Administrative Conference of the United States.

I could go on and on, but for me — and I am sure for most of the people who were present, the most unforgettable appearance that morn-
ing was that of Mr. Justice Felix Frankfurter of the United States Supreme Court. He had been on the bench of the Supreme Court of the United States for 23 years. His talk was an outstanding tour de force. He spoke for, I suspect, 30-35 minutes, without a manuscript, without a note, and his comments were learned, perceptive, concise, and characteristically most articulate.

He traced the history of the Commission, named some of those who, in his opinion, had particularly graced its bench. But most of all he defined and he identified the characteristics that, in his judgment, had made the ICC the model for the many agencies Congress devised through subsequent decades.

Listen for a moment to Mr. Justice Frankfurter. Talking about character, he said:

In the first place, the Commission illustrates throughout its life unblemished character. I don't merely mean character in the crude sense of the word, but character in its largest affirmative sense, character meaning a fastidious regard for responsibility, a complete divorcement between public and private interests and all other concomitants of a true and worthy conception of public duty.

And he spoke of the competence of the Commission:

Secondly, I would say we are here to celebrate as striking a manifestation of competence in government as any I know of in the three branches. With all respect for those — and I say this after having thought a good deal about it — my deep conviction is that so far as competence with reference to its responsibilities which from 1887 to this day have been invested in it, this Commission has as high a record of competence as any element of the government.

Third, he spoke of the persons who had served on the Commission and the independence they demonstrated. In that connection, he cited the example of Commissioner Joe Eastman, who exhibited such complete independence from the Executive Branch that his reappointment was in serious jeopardy for some time. However, he was finally reappointed by President Herbert Hoover. In fact, Commissioner Eastman earned the distinction of having been appointed by four Presidents — Wilson, Harding, Hoover, and Roosevelt — and his independence was demonstrated by the fact he never asked to be reappointed.

Then, Mr. Justice Frankfurter suggested that the Interstate Commerce Commission served as an excellent laboratory for solving governmental problems in the domain of economics.

I am sorry that Mr. Miller has left.

Finally, in noting that he had served 23 years on the bench of the Supreme Court, he said — and I think this is typical of Mr. Justice Frankfurter:

I want to say it is very generous of the Commission to ask me to take part in
this event, because while for 23 years as a teacher of law I lectured about the Commission, during the last 23 years from time to time I have dared to lecture to the Commission. Being an independent body, it has, I need not tell you, paid very little attention to my lectures.

I commend this document to you. I had to go to The State Library of Ohio to find it. It is reported in House Document 294 of the 87th Congress; the full record of the proceedings on that day are contained there.

I would urge you also to read the 76th annual report of the Commission which refers to the 75th anniversary. Interestingly, it reports that on the same day on which the celebration of the 75th anniversary took place, the Commission received a message from then-President Kennedy. The report reads:

On the same day the President transmitted to the Congress a transportation message. The President asked for a more coordinated federal policy, a less segmented approach, equality of opportunity for all forms of transportation and their users. He called for more reliance on competitive forces and less federal regulation.

Still a cloud no larger than a man’s hand, but the beginning, I think, of the emphasis on deregulation.

Our first speaker today will discuss the first 25 years of the Commission. His appointment to this task is fortuitous, because he is the great-great-grandson of the first Chairman of the Interstate Commerce Commission, Judge Thomas Cooley.

George Chandler joined the ICC staff in 1957 as an attorney in the former Bureau of Operating Rights. He served as a Branch Chief, Assistant Chief in the Section of Proceedings, and Chairman of Review Board Number Two.

In 1967, he left the Commission to become a Special Assistant to the First Undersecretary of the Department of Transportation. Later at the Department of Transportation he was a Division Director in the Office of Planning and Program Review.

In 1969, he left the Department to go into private practice, but returned to the Commission in 1970 as Principal Legal Assistant to George Stafford. He headed up the Commission Task Force on the Northeastern Railroad Problems, created following the bankruptcy of the Penn Central.

He was appointed Director of the Rail Services Planning Office upon its creation in 1974 and remained there until that job was finished in October of 1975, and then rejoined Chairman Stafford. He later served on the staff of Commissioner Virginia Mae Brown.

He was the first Director of the Policy Review Office created by Chairman O’Neal. He became Associate Director of the Commission’s Office of Proceedings in November of 1978. In June of 1980, he gave up those
administrative responsibilities to resume a decisionmaking position as Chairman of Review Board Number Two.

In 1983, the number of review boards was reduced, and George accepted a position as Senior Attorney in the Rail Section of the Office of Proceedings. He held this position until his retirement from the federal service on August 4, 1984.

To share with us his views on the history of the ICC from 1887 to 1912, here is George Chandler.
MR. CHANDLER: Thank you.

Let’s go back a little further first. The year 1873, if you will cast your minds back, was a very bad year for the railways. It was not a very good year for anyone actually. There was something called the Panic of 1873, and of course the Republicans, as once again and as usual, were about to lose control of the Congress. The railroads were in the middle of it all. The panic was really precipitated by the financial failure of Jay Cook, who was the financier behind the Northern Pacific, and 1873 found about one-fifth of the nation’s railroad mileage in bankruptcy. That may sound familiar to some of you.

Incentives, which Mr. Miller has talked about, such as the 150 million acres or so of public land that were given to the railways together with fantastic opportunities for profit, both in railroad operation and in railroad construction, had led to a tremendous over-building in areas of the country that were still really empty. Having built their tracks, the railroads then went out and rustled up some settlers. They planted them along their lines, and then, not surprisingly, they proceeded to exploit this first generation of captive shippers. The result, quite naturally, was public protest, centered largely in the farming communities of the upper Midwest.

These were issues made to order for a rising organization called the Patrons of Husbandry, usually called the Grange. A spokesman for the Granger Movement attacked many economic and financial evils of the day, but their target was railroad rates and the rates charged by other middlemen that stood between the farmer and his markets. Grange’s first big success at the polls came in 1874, particularly at the state level, and
the result was the passage of railroad regulatory legislation in a number of Midwestern states.

In the early years of railroading, railway building and operations were characterized by positive thinking and equally positive action. Railroads were not seen as a threat, and the railroad legislation of the period before the 1870s was primarily devoted to chartering new carriers and providing incentives to persuade them to build lines where individual state and local governments wanted them. So the new rail regulatory legislation was the first kind of statutes of this sort. They were directed almost exclusively at rate levels. They set upper limits to the amount that carriers could charge, and universally they established regulatory commissions to carry out their functions. These laws were generally upheld by the courts as legitimate exercises of public power over common carriage.

However, by the time the new laws had gotten on the books, the Panic of 1873 had been followed by a long lasting general depression. Rate levels ceased to be such a big issue. Rail revenues fell by approximately one third between 1870 and 1880.

Shipper complaints, however, did not come to an end. They simply changed direction. They shifted to new and equally undesirable railroad practices, such as wholesale discrimination against individual people, communities, and commodities. These are practices which the state maximum rate laws were, of course, not even intended to address.

At the same time, worsening financial conditions led to a degree of sympathy for the railroads' problems. Legislative concessions weakened what few regulatory constraints there were. This may sound familiar to some of you, too. Moreover, state regulation was proving ineffective because it necessarily stopped at state lines; whereas, most of the traffic was becoming longer haul, interstate in nature.

The railroads now are becoming even more unpopular with their customers, but they are also becoming pretty unhappy about themselves. The over construction of the past two decades together with the general economic malaise in the country had made it increasingly difficult for the carriers to turn a profit by competing with each other, and they were thus inclined to turn more and more to mutual agreements, to cut up the markets and share the profits, the railroad pools. The organization of pools began in earnest in the 1870s, but actually they never worked very well. Railroads were really not able to subordinate their own private interests in order to work together effectively. Various schemes were tried in efforts to make the pools work. One pool, in an attempt to provide a strong and impartial hand at the helm, appointed, as its Chairman, a distinguished jurist from the State of Michigan named Thomas M. Cooley. That did not work very well either.

More and more railroad executives began looking to the federal gov-
ernment for help. This may sound familiar too. They had already sought federal legislation to protect them against the attacks of such subversives as Grangers and strikers, and they began to see a federal regulatory presence as preferable to piecemeal state regulation of their affairs.

In the 1885 hearings on the bill which was to become the first act to regulate commerce, all but one of the railroad witnesses favored federal regulation. When both sides want something, Congress is usually ready to act. There were substantial pressures from the railroad interests in the drafting of the first Interstate Commerce Act, as Mr. Miller has mentioned, but I think we nevertheless have to describe it as pretty effective consumer legislation. It did contain provisions which the railroads were quite willing to live with. These included requirements that rates be reasonable, that unjust discrimination, preference, and prejudice be abolished — or at least they were made unlawful. We never abolished them — tariffs were to be published and rates could be raised only on 10 days notice.

However, the new law also contained a number of provisions against which the railroads had lobbied with great effort, principally the outlawing of pooling and the charging of a higher rate for a short haul than was charged for a longer haul over the same route. That provision, as most of you know, was enacted as Section 4 of the act and has since been called the Fourth Section.

So, a hundred years ago the country got its first real federal regulatory statute. It was both broad in its scope and comprehensive in its details, and I think it was a pretty remarkable achievement.

Another provision of the new law set up the Interstate Commerce Commission with five Presidentially appointed members. As Bob Minor has said, I have a personal interest in one of these men, for Thomas McIntyre Cooley, the first Chairman, was my great-great grandfather. Judge Cooley was without any doubt a most distinguished jurist and legal scholar. He had been Chief Justice of the Michigan Supreme Court for over 20 years. He was the founder and for many years taught at the University of Michigan Law School. One of my law professors, not at Michigan, once described him to our torts class as a one-man American law institute. He wrote treatises restating the law in fields as diverse as constitutional law, tax, and torts.

Despite all these activities, Judge Cooley had time to spend a lot of time working for the railroads. His chairmanship of one of the railroad pools has been mentioned, and at the time of his appointment to the Commission he was serving as receiver of the Wabash. Apparently, it was his association with the railroads, which were pretty unpopular in a populist kind of state like Michigan, which led to his defeat when he ran for reelection to the Michigan Supreme Court in 1884. He was a Republican but was appointed to the Commission by President Cleveland, a Demo-
The other four original members of the ICC, I think without too much exaggeration and denigration, can be described as a recently defeated Congressman and three railroad lawyers.

Whatever their backgrounds may have been, they were ready to go to work. On the 31st of March, they moved into a building on F Street between 13th and 14th, on the north side of the street, still there, and had their first meeting. This was only a week after the last appointments had been cleared by the Congress. Already, on April 5th, the effective date of the Act, we find Judge Cooley engaged in a spirited correspondence over the proper way to apply for Fourth Section relief with no less a person than Leland Stanford, President of the Southern Pacific.

The accepted wisdom is and has been for many years that the Commission faced an impossible regulatory task due to the vagueness and inadequacies of the original statute. The vagueness charge, in my view, is unfounded. The 1887 act is no more vague than most of the laws passed by a timid Congress trying to balance opposing constituent views. It is in the nature of legislators to waffle, and it is the duty of enlightened regulators like you — and like I used to be — to make their waffling work in the real world. Words like “just and reasonable” lack specificity, but they have proved to be pretty useful and I think even pretty understandable criteria for a good many years.

On the other hand, the lack of power on the part of the Commission to enforce its own orders, to conduct investigations that had real teeth in them certainly made its task difficult. But it cannot be said that it was entirely without blame for the difficulties it encountered.

That first decision, which Mr. Miller mentioned, to grant Fourth Section relief was one of many. The Commission granted Fourth Section relief almost without looking at the papers, I think. It never really pushed very hard to persuade the world that it had the authority to set rates for the future. But the basic problem faced by the shippers in dealing with the new Commission was getting their cases decided at all. The Commission gave informal opinions, but only to railroads. So a railroad could get a quick answer very cheaply to a question which a shipper would have to get answered only by going through long and expensive litigation.

The Commission tried to deal with most of its complaints informally. Of the some 9000 complaints it received before 1900, it disposed of about 90 percent of them as informal matters, and even so its cases during that period lasted about four years. But regardless of any of its own shortcomings, by 1900, judicial decisions had made effective implementation of the act virtually impossible. The power to establish rates for the future was denied to the Commission in the Social Circle cases in 1896. The Fourth Section was virtually destroyed by the Supreme Court in 1897, and I think by today’s standards we would say that the Court’s interfer-
ence was particularly heavy-handed and really quite unjustified. They ruled against the Commission on narrow grounds of statutory interpretation—yes—but they also imposed their own economic theories and reversed the Commission purely on theoretical bases.

Shippers began to press in earnest for improvements in the statute, and the railroads ultimately came around to the same position. The Court's decisions had in effect left the railroad industry without the services of its umpire, and the railroads were not able to get along with each other without him.

The final straw for the carriers came in rulings that railroad collective ratemaking associations, which had been established with the full support of the Commission, were engaged in unlawful restraint of trade in violation of the antitrust laws. The result was a general clamoring for new legislation, and beginning in 1903, we see a series of important changes in the act, all designed to increase the strength of the Commission and to add to the ammunition available to the railroads' customers.

The Elkins Act of that year made it unlawful to charge any but the published tariff rate. The Hepburn Act of 1906 expanded the Commission's jurisdiction from just railroads and railroad-associated water carriage to include pipelines, sleeping car and express companies, spur lines, and railroad yards. It authorized the Commission to prescribe rates for the future, to fix divisions of revenue among the connecting carriers, and to regulate car hire. It empowered the Commission to enforce its own orders. It established what became the basis for the Uniform System of Accounts, and it increased the size of the Commission to seven members to do all these new things.

I. L. Sharfman, who is a very diligent and lengthy, wordy historian of the ICC, said of the Hepburn Act that — and I quote, "It settled once and for all the fundamental dominance of public over private interests in the functioning of the railroad industry." Brave words, but there may be some here that do not fully agree with them.

In 1910, the Mann-Elkins Act, gave the Commission power to suspend rates pending investigation, gave shippers for the first time the right to route their own traffic. It also created the Commerce Court, which was given exclusive jurisdiction over the Commission's decisions. The Court soon took it upon itself to become the chief regulator, substituting its judgment for that of the Commission. In 1911, it reviewed 30 ICC decisions and reversed 27 of them. That was too much. In 1913, it was abolished.

During the same period, there was increased public and congressional concern about railroad safety. The Commission's responsibilities in this area were gradually increasing. The first Safety Appliance Act had been passed in 1893, but it was not fully implemented by the Commission until 1900. Again, narrow judicial interpretations, particularly in defining
“interstate commerce,” rendered the safety provisions largely ineffective. But, by 1911, new legislation had firmly established the Commission’s authority to enforce laws governing safety appliances and the hours of service of railroad employees.

We’re now coming to the end of the Commission’s first quarter-century. At that time, in 1911, it was faced with the necessity of making a big decision about railroad rates. The general increase request had been filed for the carriers nationwide. This brought the Commission face to face with a formidable presence, one Louis D. Brandeis, who filed a brief before the Commission and orally argued in January of 1911, opposing the rate increase.

He advanced the principle of scientific management, arguing that railroad managements were so totally inefficient and wasteful that they could not possibly justify any rate increase. The Commission agreed with him and denied the increase. So we find here at the end of the first quarter-century of the Commission, before World War I even, economists are arising to take an important place in regulatory affairs. Whether for good or for ill, I’ll leave that for others to decide.

Thank you.

MR. MINOR: Thank you, George. Our next speaker will cover the period from 1912 to 1937. Bob Calhoun is a graduate of Tufts College, his undergraduate degree at Tufts, Yale Law School and Yale Graduate School, his master of Arts and Economics. Admitted to the District of Columbia Bar, the U.S. District Court for the District of Columbia, and the U.S. Court of Appeals for the D. C. Circuit. He joined the Commission in 1963 as an attorney adviser to former Commissioner, Charles Webb, and became Legislative Counsel to the Commission in 1967.

He went to the U.S. Department of Transportation in September of 1969 and stayed there almost a year. He’s been a partner in the prestigious Washington law firm of Sullivan and Wouster since 1971, specializing in transportation and energy regulation and litigation.

He’s written articles for the Practicing Law Institute and has to his credit a book entitled The Interstate Commerce Commission: Cases, Rules and Administrative Discretion.

A member of the City Council of Alexandria, Director of the Washington Metropolitan Area Transit Authority, and Commissioner on the Northern Virginia Transportation Commission — Bob Calhoun.
MR. CALHOUN: Thank you very much, Bob. The problem I have with my particular period, which covers from 1912 to the Commission’s 50th anniversary in 1937, is there’s an awful lot to cover.

I have about two hours worth of material in front of me. I’m not going to read it all, I promise you. But it shows you the diversity, the complexity and richness of one of the most complicated periods in American history. It happens to end the same year I was born. As the Commission is celebrating its 100th anniversary, I’m celebrating my 50th.

What you’re going to be hearing about this period, which spans Woodrow Wilson’s first term to well into the beginning of Franklin Roosevelt’s second term, is going to be from a number of different perspectives. I would like to outline a few of these so you’ll see where some of the remarks come from.

They come first and foremost in my having worked for the Commission, both for Charlie Webb and then later as Legislative Counsel to the Commission, which I think were some of the best years I had in my life as a lawyer. Being a public servant in this agency, the people were wonderful to work with as individuals — dedicated, hard-working and very smart.

One of the things inherited when I was legislative counsel here was an enormous collection of documents. These are the archives of the Commission’s legislation. Documents are the footprints of history. They give you a feel insofar as written words can do for what people thought
about, what they talked about, what their aspirations were and what they hoped would happen.

And that is particularly true of this period. What you will see in handwritten notes from the Committee on Legislation and the chairman of the Commission on various documents are not just the grave bureaucratic mass of paper, the one associated with government, but men who were very interested in their country, in their transportation system, and their role in making the two mesh one with the other.

One of the most difficult periods in American history was during the 1930's, in the Great Depression. And that's what we're going to be talking about to a large extent in this particular period; the influence of very dynamic, very radical, very dangerous times in the economy and the history of this country. And there was great fear that the institutions, both economic and political, would get changed in a very fundamental way.

For a person of my age and my generation, I only listened to my parents talk about the Depression, about communism, about radicalism, and about hungry people and strikes. And you go back and read it; it is a marvel and it should be to the institution of this country, to which this institution played a very large role in that we all came through it.

I'm also influenced, I am forced to tell you, by the fact I also have a degree in economics. I don't have a Ph.D., like Dr. Miller, but I do have a Masters on the subject and it is in transportation economics.

I studied under Kant Healy, who was kind of a heretic about this agency. I also studied under Dr. Miller. As you heard him mention, I was his first boss, so if you want to blame me for hiring him, fine.

Jim Miller and I used to argue a lot about this agency, and I do agree with part of what he said. And that is that railroads were a lot more competitive when this agency was founded than conventional wisdom would tell you.

I do not agree with what I consider a revisionist review of history, that the Interstate Commerce Act constitutes a conspiracy against competition, or a conspiracy between the railroads and the Commission to do in the public interest. At least not during the period George Chandler talked about. That came later, in the period I'm going to talk about.

Because, if anything, Commissioner Aitchison referred to the period George Chandler talked about as the period of enforced competition. No fooling, anti-trust laws applied to mergers, rate bureaus, and so forth. And the most the Commission could do was to shave off the rough edges.

But, by and large, it was everybody for themselves. By 1912, and more importantly during the First World War, as a result of the general increased cases that George alluded to, the railroad industry in this country was in pretty bad shape in terms of earnings, too many railroads, too
much track, and service falling apart. We had to take over the railroads through the United States Railway Administration in 1917 and 1921. That forced a new way of thinking about regulation and about transportation. In particular, it suggested that competition in and of itself was not a good thing. It was not something to be suppressed, but it was not something to be valued above all of their objectives.

Now, here I will also have to take issue with one of Dr. Miller’s good friends, Tom Moore, who teaches at Stanford, and Gabriel Cocoa, whom many people quote. I regard both of them as revisionists also, in the sense that they would like to tell you that railroads basically were always monopolous, and all the Commission did was fortify it.

That also happened in this period. But it happened for a reason. In 1920, we had a choice in this country to continue things the way they were, which nobody wanted to do because it didn’t work. The federal control period showed that the railroad industry was an industry, one railroad company — with a lot of parts — but still one company.

We made a choice. We could nationalize the system. A lot of people thought that was rather a terrific idea. Commissioner Eastman thought it was a good idea.

A lot of other people had said, well, what you ought to do is let the railroads run themselves. You just get out of the business and you have a kind of economic socialism, if you want to call it that, or industrial syllogism, modeled after the Italian and Spanish form of government at the time, where the industry policed itself.

The act of 1920 and the other acts that you’ll hear talked about, in a sense, are a compromise between those competing views, of private cartelization on the one hand, and public monopoly or nationalization on the other. They contemplate private management, private ownership, private operation, with the understanding that the Commission is going to do more than just process complaints. It’s also going to regulate this industry. To quote from the Supreme Court decision of the time, “Maintain a railroad system adequate for the people of the United States by placing the railroads under the Faustian guardianship and control of the Commission.”

Now, the 1920 Act stated its central premise was to do that, but we didn’t get rid of what George Chandler has talked about. And that was laws dealing with discrimination and reasonable rates, and so forth, which were like pro-shippers as distinct from pro-carrier. What was supposed to happen was this: we were supposed to get an era of stable rates, a prosperous railroad system, good service to shippers, predictable results, instead of ad hoc litigation either by the Justice Department under the anti-trust laws (this was the era of Keough, by the way, for those of you who followed that particular subject) or ad hoc complaint litigation. The Com-
mission was going to become in effect, a planner and a regulator, not just a court.

Jim Landis, who wrote a book called *The Administrative Process* in 1938, described what he saw the Commission had been transformed into. He said:

These men, the members of the Commission, as they now view their duties, are no longer content to base the justification of their stewardship upon achievements that merely assure reasonable rates and the absence of discrimination. Instead, the ills of the industry have become their bailiwick. The policies they must formulate must now be directed toward broad and imaginative ends, conceived in terms of management rather than policy.

This is one of the most rich periods in legislative activity that you can imagine in transportation. So what are they trying to do? You're going to make rates nationally so everybody can make a living, defined as five and a quarter percent on the fair value of the railroad's property, whatever fair value was.

The railroad made too much money, it was going to get recaptured under the Recapture Clause and put in a bank for the benefits of railroads that didn't make enough. This was the cross-subsidization that Dr. Miller was talking of — one aspect of it. Some railroads could not cut it, like the New England railroads, so a policy was established to apportion divisions between carriers on the basis of revenue need.

This is a way of taking money out of one pocket and putting it in the other in order to begin to have a railroad system, as distinct from, individual carriers. That was the concept.

You also had the situation of mergers and control of entry and exit that Dr. Miller talked about. Entry was the thing they were more concerned about. Too much railroad building in this country resulted in a lot of railroad bankruptcies and the excessive competition that people sought to control. As it turned out, the railroad industry was going the other way. Most of the Commission after 1920 was abandoning railroads rather than building new ones, although you're looking at a person whose trying to get a railroad built. It's taken me five years to gum through this place to get it done, but it can happen.

But all of this was to ensure that shippers paid no more than they needed to pay, and that railroads did not waste the money received on things they did not need to do, the need being defined by the law and by the Interstate Commerce Commission.

You cannot help but read the decisions of those periods to know the people individually, the members of the Commission, who spent a lot of time personally thinking about these issues. I have seen decisions in draft form in this period where you'll see the Commissioner's handwritten notes. This is the day of no xeroxing. So, secretaries were madly typing
50 carbon copies of every decision to circulate it for voting. So you'll get the benefit of the individual comments off of those carbon copies.

Now it's instructive to know one thing that this act didn't do. Remember, George Chandler talked about the Rate Bureau cases. There was no Rate Bureau language in the 1920 Act. The Commission and the Justice Department seemed to have entered into some sort of a treaty of peace not to kick sleeping dogs. Rate Bureaus didn't go away, even though they were supposed to be illegal under the anti-trust laws.

The Commission occasionally would talk about them in the reports, but there's a tendency of "don't rattle cages" about that subject. Everybody kind of went along with the game until 1938, when Thurmond Arnold decided: Well, we can't have things like the National Recovery Act and legalized cartels and suspending the anti-trust laws. Let's make them mean something.

The first anti-trust case that he brought was against the Rate Bureau. It's known as the Lincoln case in transportation history, which eventually led to the Bullwinkle Act in 1948.

Now, by and large, I am forced to say — at the risk of also being a party-pooper — a lot of this stuff didn't work. It didn't work for two or three reasons.

First of all, it asked too much of a legal system. Any of us who are lawyers know it's a lot easier to tell people "don't do that" rather than "we'd like you to do this, and like you to do this, and like you to do this," and a person will say "I don't want to do that."

The Commission's master merger planning process is a classic example of trying to roll a stone uphill with your nose. Congress gave the Commission the task of replanning the whole railroad network in this country and do a few systems, but they did not give them the resources to compel it to happen, either legal or financial. The railroads said, "It's not in our interest to do it," and didn't do it. That exercise in master planning, which was probably more ideologically insensible in the first place, finally had to be repealed.

The practical problems of determining excess earnings for a railroad were just unwieldy and unmanageable. In addition, starting in about 1929-1930, railroads weren't earning excess earnings in any case. There were no excess earnings to share in the industry as a whole, so that process went down the tube.

That goes to the second reason why the stuff didn't work: you can't regulate something without eventually trying to regulate everything. One thing government has never succeeded in doing was regulating the weather. The agricultural sector in the United States economy went through endless misery, as it continues to do, during this entire period.
The Commission was plagued with equally endless misery from Congressmen, and from non other than Warren Harding, who was supposed to have come to the Commission personally to intercede on behalf of farm and agricultural people to reduce rates of the railroads. Keep in mind, this is at the time the Commission is under a mandate to increase rates to ensure adequate earnings. The Commission’s caught in a crack. No matter what it does, it’s going to get yelled at. If the railroads don’t prosper, they’re going to get yelled at; if the farmers don’t prosper, they’re going to get yelled at. A totally impossible situation for the Commission. No matter what you do, you’re going to be wrong. That is not unique to this period, but it has been a problem with regulation all of its life.

More importantly, when you are trying to restructure an industry, the focus was on financial aspects. It was thought that the big bad bankers, like J.P. Morgan and Bernard Baruch, were really the problem of the underlying structure of the railroads. Just restructure the bonds and the stock and stop putting out watered stock, and what have you, that would cure most of the problems.

It didn’t. A lot of railroads went into bankruptcy, a lot of them two or three times.

But neither the Commission nor the Congress was willing to face up to what had to be faced in the 1970’s. If you want to restructure the railroads, you’ve got to be mean about it. You’ve got to be a dictator, this is what we’re going to do, this is what we’re going to pay for and this is what it’s going to look like.

And to a large extent, that’s what Conrail was all about. They tried to learn from the experience of the 1930’s that you must do it comprehensively, or don’t do it at all and come up with that particular process.

One cannot talk about this period without noting briefly two other things. One is competition by other modes and the other is the Motor Carrier Act. I want to talk about something that’s more interesting than anything else, and that’s Joe Eastman and Franklin Roosevelt.

You’ve already heard some talk about the Motor Carrier Act, so I won’t go into what that law is all about. I think most of you are familiar with it anyway. What’s more interesting is the choice the Congress had and rejected until 1980.

The Motor Carrier Act of 1935, as I think most people know, was the product of the Coordinator of Transportation’s basic bill. But there was a different approach, which nowadays would be called a fitness only approach: Show me that you’re honest. Show me you’ve got insurance. Show me that you’re safe. Promise not to discriminate, publish your rates, and you’re in business. It’s that simple.

It is always dangerous in history to reflect on what might have been,
but it's interesting to speculate that if there had been that Motor Carrier Act passed, rather than the one that passed, wouldn't the whole world have been a lot different? It would have been a different motor carrier industry. It would have been a different Commission. It would have been a different railroad industry, because the railroad industry would have had to pull up its socks and restructure, and the Commission would have had the time to focus on it.

It was always my view when I was here, and is my view now, that the worst thing that happened to the Interstate Commerce Commission was the passage of the Motor Carrier Act. Administratively, it inundated this place with paper and became, instead of an agency that should be thinking about transportation policy, an army of clerks processing paper. The Commission in more polite terms, will tell you that it is ruining the institution, that you cannot cope with all this paper and applications.

Now, just to go on to the last item, which is more political science, somebody mentioned as a politician, these are some things I came across when I was legislative counsel here and have been looking at ever since.

We talk about this agency as an independent agency and so it is in the functional sense. It's never been quite clear what it is in the legal sense. There is no place in the Constitution for independent agency—either you're a court or you're president or you're congress. There's no fourth thing in there. But we kind of fake around it and say, well, it's a little of all three. And that's always caused a problem.

Now, George Chandler talked about the courts. In the period I'm talking about, the Commission got along with the courts pretty well, largely because there are a number of Justices in the Supreme Court who had had a hand in the Commission's work — Taft, Hughes, Brandeis — or basically understood the railroad business, such as Sutherland, who is a railroad lawyer by background. The O'Fallon case, which destroyed the Recapture Clause and made a mockery out of the valuation process, is probably the only exception to that.

The next panel is going to talk about administrative law, so I'm not going to go into the cases here, just simply enough to point out that probably the major cases that deal with administrative law in this agency were decided in the period I'm dealing with.

Same thing's true with the Congress. Congress got along with the Commission as well as anybody can ever get along with a Congress. You had a couple of rough spots. Remember, Agency Commissioner Hess was kicked out of the agency. They wouldn't give him another term, because they didn't like his vote on a particular case. You'll find when Hodge-Smith resolutions passed, there is some internal correspondence
of the Commission saying that "Congress is meddling in our business, and they don't know anything about it."

By the time you get down to the end of this period, the Commission's legislative committee, Swann, Atchison, McHaffey, apparently got along pretty well with people like Senator Wheeler, Clarence Lee, Sam Rayburn, who were really kind of the architects of the major legislation of this era. And they apparently spent Saturday mornings with him talking about Commission's legislation. It's always been my suspicion that the reason they got along so well was they had a common enemy, and that was Franklin Roosevelt.

Franklin Roosevelt had a lot of problems with this agency, and particularly with Joe Sveesman. The problem was they were two very stubborn people. They each had their own views on what their role in life was. They apparently got along fairly well most of the time, but they also had their share of quarrels. It was primarily whether the President had a right to meddle with this agency. Now, it didn't start with Roosevelt, it actually started with Woodrow Wilson, which is somewhat ironic, because Wilson, as the Professor of Princeton University, had written an essay called On Administration, which is also celebrating its 100th anniversary next month. And the central premise in Wilson's essay was that once Congress passes the laws, once the President signs them, you appoint neutral administrators to carry them out. The law is what the law is, and politicians know nothing about laws once they've done their piece of the work. And he summarized it in this fashion: although politics sets the task for administration, it should not be suffered to manipulate its office.

When Woodrow Wilson became President, he changed his mind. Woodrow Wilson sent some mail over here saying: I would rather try to influence the Supreme Court than the Interstate Commerce Commission. On the other hand, I think the bankers and the railroads have made a good point, they need a rate increase.

Now, these were publicly sent to Commissioner Daniels, who had been a colleague of his at Princeton. The Commission paid no attention to that. So then Wilson went public, went up to the Congress, State of the Union Address, and said: the Commission has got to understand the railroads need a rate increase.

The Commission said, "We don't care. We brand this as right, and you're wrong." And turned it down. And Wilson tried to pack the Commission by adding some members down here to get people to go his way.

The next person was Warren Harding. You know, I haven't been able to document this story, but there's this wonderful tale that Warren Harding was supposed to have come to the Commission at a conference while they were discussing a rate case. He was told to leave, that it was improper for the President of the United States to try to influence the Com-
mission, and he hadn’t been invited: “You’d better leave.” And Herbert Hoover did the same thing — was told the same thing. I mean, he was meddling.

The 1930’s had so much legislation, it was necessary for the President to bring some order in all of this, to get some clearance. So they sent around what is the ancestor of the Budget Bureau circular that says: If you’re going to submit legislation to Congress, it’s got to go to OMB first. And at the bottom it says, “This legislation is consistent with the President’s program.”

By and large, the Commission told them, “We’re an independent agency. You have no business telling us what to do. You control our budget and our appointments, and that was all.”

Well, for a while, it was kind of touch and go, and then the Commission lucked out. The Supreme Court decided the case of Humphrey’s Executive vs. United States, which said just that.

And, finally, the President apparently called Joe Eastman over to the White House, and then wrote him a letter, which I have in front of me if you want to actually see the copy of it. But I’ll just read you one sentence out of it:

In the case of the independent Commissions, all that is requested is proposed legislation be taken up with the Executive Branch of the government.
That is a simple request in the interest of orderly conduct of the government and in no way seeks to destroy the independence of the Commission.

I’ve never been able to find the answer to this letter, but I suspect it was: “Thank you, Mr. President, but drop dead.”

Basically, the Commission eventually raised a compromise, which I inherited as legislative counsel, and that is, you give them to OMB five minutes after you give them to the Congress. I think that’s still a practice here.

Not to be put down, they tried it another time in 1937. And this time the Commission just simply said: “you don’t have a legal authority. Humphrey’s Executive says we’re not accountable to you. Most we’ll do is we’ll send it to you after we send it to the Congress.

Now, the last piece, though, was the Roosevelt Administration. They never gave up. Bureaucracy is tenacious, if nothing else.

We’re also celebrating the 50th anniversary this year of something known as the Brownlo Commission, which was otherwise known as the President’s Commission on Administrative Management. The Brownlo Commission, among other things, created what is now the Executive Office of the President at the White House. It also recommended the placing of the ICC in the Department of Commerce as a Bureau within the Department of Commerce. And characterized this agency and its counterparts, like the SEC and the FEC, as being a headless fourth branch of the gov-
ernment. The Commission's comments on that were quite unmerciful and quite unforgiving and they are found in the last volume of Mr. Sharkon's book, if you have the opportunity to read them.

Finishing up, the Commission and Franklin Roosevelt made up here in this very room. At the 50th anniversary celebration, Franklin Roosevelt wrote a nice letter to the Commission and said:

The Interstate Commerce Commission is fortunate that interpretations of our charter of liberties — meaning the Constitution — have allowed it to function during the past half century through recognition of the fact that an obviously national need can be met only through obviously national action.

Thank you.

MR. MINOR: Thank you, Bob. Bob's reference to the voluminous records and reports of the Commission reminded me that on that same occasion that I spoke of earlier, Mr. Justice Frankfurter opined that the Commission obviously worked harder than the Supreme Court because we had generated more volumes of reports than the Supreme Court had in half the time.

Our next speaker is a graduate of Goucher College, with a major in Mathematics, was elected there to Phi Beta Kappa. She took graduate work in Math at Johns Hopkins, resulting in a Master of Arts degree in '31, and a Ph.D. two years later.

She taught at the University of Richmond and got another master's degree in Economics at the University of Oregon and was an instructor there for a period of two years, before joining the Interstate Commerce Commission.

She worked at the Commission part-time at first, and later assumed a full-time position beginning a long and distinguished career in government work, 30 years in Transportation Economics.

She practiced her skills not only at the Commission but at the Office of Defense Transportation until, in 1953, Post Master General Arthur Summerfield asked her to come over and try to make some sense out of the transportation economics at the Post Office. She held at that time the highest position of any woman in the Department — and in the entire history of the Department.

Probably her most significant contribution was heading a staff of 30 persons who worked on trying to organize the transportation of mail throughout the country. And her work in that area and the work of her colleagues was so successful — we were chatting a moment out in back before the panel began — that, in one year, she calculated that $50 million was saved the American user of postal services.

She has been recognized by prestigious awards by nongovernment groups, Federal Woman's Award in 1961, which was the first year the
award was made; and in 1970, the National Civil Service League gave her its Career Service Award.

It's not surprising that Dr. Beatrice Aitchison has had such a distinguished career. As most of you know, I think, her father, Clyde Aitchison, was a member of the Interstate Commerce Commission from 1917 to 1952, a period of 35 years, a record which probably will stand for all time. Certainly no one has approached it.

It's a great privilege for me to present to you Dr. Beatrice Aitchison.
THE INTERSTATE COMMERCE COMMISSION,
1938-1962

DR. BEATRICE AITCHISON*

DR. AITCHISON: Thank you, Commissioner Minor. I'm hoping there's someone that's even more ancient than I here, that goes back farther than I. Did Mary Park Clements get here? Mary Park... I don't see her.

She lives about two blocks from me. Her father was a member of the House in 1887 and voted for the act to regulate commerce. He was appointed to the Commission in 1892 and died in office in 1917, being the first of the few Commissioners who served as long as 25 years.

Mary Park I see regularly at the Safeway, and we talk.

We go back. She knows the F Street Building. I don't. But my relation with the ICC — I'm not going to stick to my years particularly. It's a little difficult. But my relation to the ICC goes way back to 1917 when my father was appointed by President Wilson.

His office was on the 11th floor of the building on the southeast corner of 18th and Pennsylvania Avenue, a fine place to see the suicides from the Powhatan Hotel roof. That was just across the street from the small building where he had moved the office of NARUC whose Solicitor he had been for about a year and a half.

The Commission worked on Saturdays in those days, and I was permitted to come down occasionally for lunch in the cafeteria that the girls had developed for the employees. We had a lot of pretty girls. Some of them are here today, I know.

This was the beginning of the InComCo Club, I think. World War I

* United States Postal Service
was on, and the ladies of the Commission, meaning wives of all the men who worked for the Commission, as well as of the Commissioners, had established a Red Cross bandage-making unit in one of the 11th floor rooms. Even little girls were permitted to come there on Saturdays to do their part. And certainly a little girl was permitted to join the big girls in pushing War Savings Stamps down by the front door.

Much later, I learned to drive and would maneuver into the court of that building, about three right angle turns in different directions. Of course, I dented a fender one time and that was the end of that.

In my early days, which followed Mary Park Clements, there were lots of picnics and parties. I remember the heavyweight fight one July 4th, when Brother Joe Eastman won the pool and bought ice cream for the crowd.

We climbed trees out at the Meyer’s place — now the beautiful stone headquarters of Sidwell Friends School. We danced on their ballroom floor, moved there from Wisconsin, and then on to their P Street house.

Our mothers were apt to pay the appropriate social calls riding in Mrs. Meyer’s electric, recharged each night.

Most of us went to the local public schools, Western and Central mostly, unless we were problem kids like my brother, and on to colleges and universities.

The most threatening thing I remember about the old ICC building at 1776 Pennsylvania Avenue was what I was told, that John Switzer of Personnel spent early mornings looking out the second floor window above the main door noting to see who got there five minutes or two minutes late, and then waiting to see that annual leave request come through.

There were some other beauties, too, in Director Switzer’s too-strict orders, especially the one during the War. I think he had the cafeteria closed except between 11 and 2, or something like that. These too strict orders were deliberately and publicly ignored by Commissioners, with great glee.

Other than paying little attention to what was going on other than prompt receipt of my allowance, and noting that my father seemed to spend most evenings and weekends in his basement office at home — that was the Interstate Commerce Act annotated going on — my ICC attention continued to be centered on the party end of things.

There were some New Year’s Eves doosies, when, at midnight, the incoming chairman took over a huge leather hat box, undoubtedly from Sloan’s Auction, designed to hold the high silk hat he was supposed to have as he led the brethren to the White House to wish the President “Happy New Year” the next day. The “chairman’s new wife”, so phrased
very deliberately, fell heir to the crown jewels from Woolworth's and a lace curtain train.

So things weren't all work. Those were the days when one had time to play, when one could really get acquainted with one's colleagues, even taking dancing lessons together. And some of them, I can assure you, needed them.

There was a certain amount of camaraderie between rank and file, too. The InComCo Club sponsored a family feeling. The Interstate Male Chorus, which sang here where the acoustics have not improved a bit, was really a jewel in the crown of the Commission. It sang at the White House for all Presidents from Coolidge on to Roosevelt. Roosevelt himself took over the baton to direct the chorus in the Bells of St. Mary's. Representative Woodrum, himself a singer, arranged for the chorus to sing at most festive and sad occasions on the floor of the House.

World War II was another matter. I became very personally involved when I hit the top of a Civil Service Register and was certified to the Bureau of Statistics as a P-1 very Junior Statistician. That was probably the best thing that ever happened to me.

From it, I learned the vital importance of one's first supervisor and I had the best, Dr. Max O. Lorenz. He and his predecessors, as statisticians for the new Commission, set standards of excellence for performance and accuracy, reflecting the integrity which must be displayed by the fledgling Commission.

Not only could one rely on what came out of Dr. Lorenz' shop from figures to language in Commission reports, but one could see the art developing. His view of transportation was broad, not restricted to the nit-picky point that might be involved in a specific proceeding, but, at the same time, he would provide a framework for the proper decision in that little case, which was important to someone.

The doctor worked with his whole staff to find and emphasize strong points, improve weak ones or move an employee to a more appropriate assignment. His young trainees and influence spread throughout the whole transportation sphere, as we grew up and moved out. I don't know if there were any of you old enough to have been at one of the arguments in a General Revenue case in the early fifties or late forties, when someone from the Maryland Cup Company — little paper cups — had five minutes of argument before the whole Commission. The Commission was punch-drunk at that point — not from anything in the cups, and it really took after that guy, cracking wise. They were wonderful and apologized to the gentleman, said that his argument, which of course he had in writing in his brief anyhow, would be considered carefully.

But they had fun together.
As I say, I had a good time where I was, but everyone helped me. Everyone in the establishment had a hand in teaching me, from whoever the chairman might be down to the telephone operators. I got spanked occasionally, too. It was a happy place to work. And why?

Well, I've had my subconscious working on that "why" for some months now. The word that keeps coming up is "collegiality." That tone was set by the 11 Commissioners and filtered down to the staff.

Maybe they disagreed. And certainly they did. But it was done peaceably. Maybe one of the brethren was not able to participate — I'm thinking of the year that Commissioner Barnard was ill and died. The rest closed ranks and did not let that hole hurt the public interest. It was essentially the public interest that was paramount. If that meant going beyond a superficial argument placed before them to advance the art, a way was found to do so.

Of course, some folks could be counted on to lean in certain directions in specific cases, and this was understood. But that was because that direction was felt to be in the public interest by those folks, or seemed to be.

In the end, there might be the unanimous statement such as this, which is in one or two of the General Revenue cases:

"It is fair to say that these conclusions and our findings and the order which implements them represent our unanimous judgment. That does not imply that there have not been differences of opinion among us as to details. But we repeat what we quoted from our report in another case of great importance, the Consolidation of Railroads, 159 ICC, quote:

'In a matter of this magnitude in scope and complexity in detail, even after the most careful study and the fullest and freest interchange of views by those charged with the duties of preparing this plan, there must remain many differences of opinion as to the several component parts, both large and small, comprised in the final result. Such is here the case. While a clear majority of us, although not always the same majority, have agreed to each part of the plan proposed, not all of us have agreed as to all parts, but all concur in the result.'"

I suppose that today the so-called Sunshine Laws would make such statements impossible.

To go back to Dr. Lorenz, this real boss for me personally figured out what made me tick — turned me loose — and showed me where I'd gone wrong when I asked for help, which I did. Then suddenly, he would take me off that project and put me on something entirely different. After I had worked on that one for a while, he would crack the whip. "You have not finished the first project. Get back to it and have it ready in four weeks!"

He would get it neatly wrapped in six, my subconscious having organized everything meanwhile.
I was allowed to get — this is the great supervisor — I was allowed to get into any interesting, if useful, trouble I could find.

This leads to the second big emphasis of my assigned 25 years, the preface of which I haven't had time to lay my hands on, but in 1 ICC some place there is a comment — there are two interesting things in that volume.

First was anti-discrimination in service in dining cars or something. And the second was: "We don't have the information we need for this decision.'"

I had an assignment at that time of matching my mathematics with prescribed class rate scales, and fast ran into too common a situation where the Commission had asked railroads for data and been turned down for valid reasons.

I also read the newspapers and saw that the Office of Defense Transportation, headed up by Brother Joe Eastman, had ordered sent in a day's originating carload way bills.

Wowie. So I went down the corridors looking for help, getting cold water all the way until I got to Dr. Lorenz, who said, "Yes, certainly we should be in on it. You find out how.'" So we found out how. It turned out later that the ODT people said "We were happy to have someone say we think you're doing the right thing.'"

We got together and my Bureau got the way bills eventually. We worked them over into a pretty good exhibit for the Class Rate Investigation, 28,300. Then, we began to play with them.

One member of Division Two had a troublesome coal case on his docket, plus an examiner who swore there were no rates in the area as low as 5 mills per ton-mile. So, we hunted up the way bills for that area and found over half the movements paid less than 5 mills per ton-mile. In other words, a rumor was replaced by a fact.

Way bill studies began to be quite respectable, especially outside the ICC. Everyone in town was trying to latch on to them. The Bureau of the Budget finally moved in and labeled the ICC Bureau of Transport Economics and Statistics, which had gathered in a lot of star analysts, as the headquarters for facts, not rumors.

We were in good shape. We knew what a way bill was. With the great Dr. Demings' help — you know, the Japanese Government gives a Demming Prize of $50,000 a year to the person who improves productivity most over there. But we hardly know he exists here — we found the efficient way of collecting our data and found the bright young man who was far ahead of the rest of the town in both techniques and accomplishments. He had used the military way bill data to turn the domestic military
traffic around on a "what-if-V.E.-Day-came-next-Tuesday basis — and hit the situation just as it finally happened.

One of our alumni sold several of the Motor Carrier Rate Bureaus on the method, so we were winners in that area, too. I told someone I wouldn't say this, but my modesty does not prevail:

My taskmaster, "Tuffie Father," who was not my boss, said in one instance that, "This Commission now knows for the first time the general effect of its decisions in dollars." Someone would suggest that on commodity "X" there be only a limited rate increase and would withdraw the suggestion fast when shown that it would have resulted in an actual decrease in revenue from that commodity.

My assistant, now dead, and I had things in such order that we could be asked from the conference room, "How long will it take you to try out these proposals?" "Thirty minutes," and we'd have them up there in 28.

There are lots of unimportant funny stories of being watched by all the watchers, to hazard a guess as to when a decision might be coming out. The guesses were 100 percent wrong.

It was fun to work at the ICC and I regretted a feeling I should move on. But then, eventually, at the Post Office Department there was even more fun, especially when the effects of recommendations and decisions could be seen in the monetary accounts.

It's great to be here today. Thank you.

MR. MINOR: Thank you very much, Dr. Aitchison. Our final speaker on this panel is a graduate of Georgetown University School of Law, having first gotten his B.A. in Economics from Duke. I think we're surrounded by economists up here. He joined the Antitrust Division of the Department of Justice, was a trial lawyer there, then became a trial lawyer here at the Interstate Commerce Commission, left the Commission to become a partner in the distinguished law firm of Tourney and Tourney; came back to the Commission in October of '73 as an Associate General Counsel; became Deputy General Counsel in February 1976.

And since July 1985 has been General Counsel of the Commission. He's a member of the Bar of the District of Columbia and the United States Supreme Court.

MR. BURK: You will all be happy to know that this is the last 25 years. The program, our part of the program, will soon conclude here.

In 1962, the Commission celebrated its 75th anniversary. It was a grand celebration. As Commissioner Minor noted a little earlier, Mr. Justice Frankfurter spoke to the assemblage in high praise of the Commission. He called it, "A blend of preserving, furthering and encouraging private incentive with due regard for effective, informed representation of the public interests where, as in all aspects of transportation, private enterprise closely touches the national well-being."

The President issued a laudatory proclamation and Congress joined in the acclaim with a Joint Resolution.

Today, 25 years later, despite the similar proclamation and resolution, the President is calling for abolition of the Commission, and the Chairman of the House Commerce Committee has branded it "brain dead".

Now, how does an institution go from effective, informed representation of the public interest to brain dead in 25 years?

That is my story to tell this morning. I have only 15 minutes to tell it, so much must be omitted. But what I'm going to try to do is capture the essence, to give you the flavor of the times that led to this end. Or is it a new beginning? We shall see.

In my view, the 25 years can be broken into three periods. The first I

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* General Counsel, Interstate Commerce Commission
call the endless summer years of 1962 through 1977, when life was good — or was it?

Then came the volcano years of 1978 through 1983 when deregulation erupted all across the landscape.

And, finally, the Tower of Babel years of 1984 to date, when one wonders what voice in the cacophony to listen to.

First, the endless summer, when the warm sun shone on us lawyers and our lives were good, real good. A couple of vignettes will suffice.

I was trying a motor carrier authority application case in Arizona, putting on strings of witnesses in town after town, day after day, all to prove a need for my client’s service.

In Cottonwood, I had reserved the Ace Steak House for the hearing and they had separated the room from the bar, with a folding partition.

Now that’s where I learned an ICC procedural rule found in no law books. While questioning a witness, I was interrupted by a protestant’s lawyer who moved we adjourn under the Pocatello Rule. I didn’t know what he was talking about.

The Examiner checked his papers and said you’re right, this is the 100th witness. Motion granted. Whereupon, he rolled back the partition and ordered me to buy drinks for the whole mob.

Now you can be sure that I always remembered the Pocatello Rule after that and I never again got caught putting on a 100th witness.

As indicated by my previous story, it was up to applicant’s attorney to reserve suitable hearing rooms. The following real letters — I’m not making these up, ladies and gentlemen, these are actual real letters. They were addressed to Chief, ICC, Judge Bamford. And they’re from an ICC docket. You may go and read them.

They’re revealing of these times I’m speaking of.

I will call the lawyers Smith and Jones to protect the guilty. The first letter states, and I quote:

“Mr. Jones, the attorney for applicant in the above matter, is a most devious individual. He has done everything conceivable to inconvenience the opposition when handling an applicant’s case. I have had trouble with Mr. Jones before, but he has finally outdone himself. In checking with the Ambassador Hotel located in Chicago, I was advised that the oral hearing in this case has been set in the bathroom.”

“With this kind of harrassment, it is my opinion that the rights of my protesting client have been violated and that the Commission cannot obtain a fair record of a hearing held in a bathroom.

I respectfully request that the hearing in this matter be moved out of the Ambassador bathroom.”

To which Mr. Jones replied, and again I quote:

“I have received a copy of a letter from Mr. Smith in which he states that
I'm a most devious and uncooperative individual. These malicious and libelous statements, while entirely true, are irrelevant."

"Having been in numerous cases with Mr. Smith and knowing how he handles himself at hearings, the bathroom is the only appropriate place to hold a hearing where he is involved."

Well, it was fun and games and lots of money, but what did we lawyers produce?

Well, for example, in 1964, we produced 472,000 pages of transcript, and we filed 260,000 pleadings.

Why? What was going on?

Well, in the motor carrier area, shippers couldn’t get service or reasonable rates, and the carriers couldn’t get authority to compete.

In one landmark case during this period, the Commission refused to grant frozen food authority and insisted that the carriers apply separately for frozen berries or frozen fruits or frozen vegetables.

In another famous case, the Commission decided on whether authority was required for chicken, depending on whether it was cut up, precooked or cooked, frozen or refrigerated, breaded and/or battered or marinated.

Well, you can see what this would lead to, and it did. Much criticism. Stung by the criticism of lack of service and rate problems, the Commission reported in 1972 that it granted 4,371 out of 5,945 motor carrier applications. It argued that interstate trucking is not closed to expanding services and operations, new entrants or reasonable competition.

But what it granted were bits and pieces. In that very same report to Congress it confessed that only one grant of motor carrier authority was for what it labeled, and I quote, a "unique single line, highly expedited, experimental transcontinental operation". Just one transcontinental operation as an experiment.

During this same period the Commission complained bitterly to Congress that illegal carriage, like a strain of virus adapting to antibiotics, is employing new disguises and devices for the evasion of regulation.

Well, given what was going on, is it any wonder?

If the motor carrier area was bad, the rail area was worse. Rate and division cases went on interminably without results. A merger wave resulted, born out of a desperate attempt to rationalize plant and stave off disaster. The failing northeastern railroads embraced each other and crashed in the Penn Central bankruptcy.

Curiously, as if with a death wish, the railroads fought all the way to the Supreme Court against the Commission’s directive to open their doors to TOFC.

In a monumental exercise in futility in 1971, the Commission noted
the public outcry of complaints of terminal delays, interchange delays, erratic delivery and car shortages of more than 15,000 cars a day, and in Ex Parte 265, it ordered the railroads to correct deficiencies and report quarterly on the remedies taken.

Of course, nothing changed and conditions worsened.


Now what was the Commission's response? Well, in their report to Congress that year, the Commissioners opined, and I quote, "The legislative guidelines that emerged confirm the congressional consensus against endorsing deregulation as a means of providing adequate protection for the public interest."

How wrong they were.

This would be a good point in our story to go back to Mr. Justice Frankfurter and his remarks in 1962 at the 75th anniversary. He said, "Institutions do not die; they commit suicide."

How right he was.

And so, in the period of 1978 through 1983 in a violent upheaval, the old institution with its Pocatello rules and its illegal carriage viruses did, in fact, die.

First, a new breed of Commissioner appeared. They were committed to reducing regulation and fostering competition in the industry. In their 1978 report to Congress, the new Commissioners pronounced the Commission to be committed to the philosophy of increased competition and said the new Commission would continue to encourage competition in the transportation industry, substantially removing barriers to entry and greatly reducing burdensome regulations.

They did just that. In the motor area, the Commission was granting 96.7 percent of new authority applications by the end of 1979, and the number of applications had soared to 10,000 a year.

In addition, by rulemakings and landmark decisions, such as the one permitting private carriers to engage in for-hire transportation, the doors to free competition were thrown wide open.

In the rail area, the Commission exhorted the railroads to become more market-oriented and use their freedom under the 4R Act for innovative marketing and pricing.

To assist in that direction, the Commission declared contract rates not to be illegal per se and encouraged their use.

Fresh fruits and vegetables were deregulated and many, many more actions were taken.

But these explosive changes did not satisfy everyone. Indeed, many were outraged. The Chairman of the Senate Commerce Committee told
the Commission privately at Reston that they were like a Frankenstein monster lurching around the countryside uncontrolled. Publicly he said, "We are mad as hell, and we are not going to take it anymore." He ordered the Commission to stop and let Congress decide on how much and what sort of deregulation should occur.

On the rail side, the general criticism was just the opposite. It was that deregulation was too little and too slow.

I would like you to hear this from a 1979 speech.

The bewitching charm of deregulation is the potential for annihilation of that wretched center of anachronistic tyranny, the ICC. Congress could-electrocute it. That's a pleasant thought. But in all equity, for its iniquity through the years, the Commission deserves the same treatment it tried on the railroads, slow death.

Let's let it, the ICC, expire in, say, five years.

Now, who said that? Well, it was a vice president of the Association of American Railroads.

Can you imagine an ARR spokesman saying that today?

And so, goaded from all sides, including by the Commission's own deregulatory initiatives, Congress acted in 1980. They gave us the Motor Carrier Act of 1980 and the Staggers Act. Now there's no one here who is not completely familiar with what has transpired since.

You all have views of those events, and I know they vary widely. No anecdotes or critique from me will change anyone's mind about that.

But there are a few points I should make on this occasion.

First, it used to be that the Commission would hear policy views presented civilly by essentially three organizations — the ARR, the ATA and NIT League.

Now, in addition, we have, just for instance, the National Small Shippers Traffic Conference, the Transportation Brokers Conference, the National American Wholesale Grocers Association, the American Public Power Association and the National Rural Cooperative Association, the Consumer Federation of America, Western Fuels Association, Consumers United for Rail Equity, Pro-competitive Rail Steering Committee, The Coalition for Rail Fairness and Competition, and on and on and on and on.

They all have their congressional spokesmen, and many have Administration spokesmen, and everyone is yelling at everyone else.

That is why I call this the "Tower of Babel" time. Who should the Commission listen to, if it can hear anyone over the general uproar? And what of the level of debate? "Brain-dead" speaks for itself. Or how about responding to an opponent's position paper with "one of the most outrageous, irresponsible and insulting things I've ever seen a professional organization do."

Now wouldn't it be nice if we could restore reasoned civil debate?
Doesn't the importance of the subject, the future of our national transportation system, merit that?

Well, where are we now on this 100th birthday? Where has the new Commission and the new legislation brought us since 1980?

Freight transportation costs as a percentage of GNP fell from 8 percent to 7 percent in five years. That's a savings of $40 billion. At the same time, the railroads have grown much stronger in financial health. Even Conrail has prospered enough to return to the private sector. The motor carrier industry is no longer a closed shop and the entry of thousands of new carriers have eliminated the service and rate problems that were the source of such bitter complaints in the 1960s and 1970s.

Are there problems? Certainly. Competitive access, for one. Differential pricing, which is okay now, as opposed to cross subsidization, which is not, if anyone can figure that out.

Of course, there are others all being loudly and bitterly argued.

What of the future? Well, the President and many supporters say the Commission should ride off into the sunset, but even many of its critics, such as CURE, in the words of their congressional sponsor, say the Commission should be restored to its mission as a watchdog.

Who will prevail? Certainly, I don't know. All I can say, in the immortal words of TV anchormen everywhere, is "Stay tuned. There is much more to come."

Thank you.

MR. CLEARY: Thank you very much, Bob Minor and all the panelists, Bob Burk, George Chandler, Bob Calhoun, and certainly Bea Aitchison. It was interested, I think, stimulating and sets a little tone for the rest of the days events.

We are, obviously, running a good deal behind time, so I think we will move immediately to our next panel. If you can stay with us, I think it will be very stimulating, on the question of the courts and the administrative process.

I would ask you all, if you could, to sit down. I recognize it is a great temptation to chat with friends, but we do have a distinguished panel here this morning, and I would like to continue with the activities.

The next panel is on the subject of the development of administrative law and the ICC, their evolution.

We are truly honored to have the panel with us today that Betty Jo Christian will introduce, but my pleasure is to introduce Betty Jo.

I have known Betty Jo since the days when she was at the Commission as an attorney in the General Counsel's Office. She became Associate General Counsel, and then she became a Commissioner during the years 1976 to 1979. I get a little overwhelmed when I see these creden-
tials, as I referenced Bob Minor's. Betty Jo was a graduate of the University of Texas, and a true Texan she is, summa cum laude.

All loyal Texans. She not only got a summa in the undergrad school, but she decided to repeat in law school. Of course, she had a distinguished service with the Supreme Court of Texas as a law clerk, before she came to Washington to join the Interstate Commerce Commission.

I have had the personal pleasure and deep challenge of having Betty Jo on cases that I have been on the opposition, and indeed, it tests your mettle, and you have a very worthy opponent.

It is a great honor to introduce Betty Jo Christian.
MS. CHRISTIAN: Thank you, John. The subject of this panel today is one that all of us who have acted as lawyers at the ICC are very familiar with, and that is, the ICC and the Evolution of Administrative Law.

Listening to the earlier panel this morning on the history of the Commission, I couldn’t help thinking that so many of the precepts about administrative agencies that we now take for granted did not necessarily have to develop this way at all. Back in 1887, an administrative agency was a brand-new creation and the men and women who created the ICC in those early years were literally establishing a framework which has permeated administrative law throughout the past century and in many ways has framed our whole understanding of what an administrative agency is.

As we review the cases in the administrative law treatises, we can’t help but notice how many of those cases arose out of ICC decisions. So I think it is very appropriate that we focus on this subject today as we commemorate the 100th anniversary of the ICC. There is certainly no agency that has contributed more to the development of the law that we now know as generically administrative law.

We are fortunate to have a truly outstanding panel to discuss this subject this morning.

I couldn’t help thinking facetiously that the panel that we have managed to assemble includes one long-time practitioner who has, over the
years, advocated what sort of procedures administrative agencies ought to follow. We have one former ICC bureau director, who had a major input in deciding how the agency would function. We have a federal judge who was in the role of deciding whether what the agency did was legal, and we have a distinguished administrative law professor who is in the role of deciding whether the ICC and the courts were right or wrong!

As our lead speaker this morning, we are deeply honored to have with us the Honorable John R. Brown of the Fifth Circuit Court of Appeals.

Judge Brown received his bachelor's degree from the University of Nebraska and his J.D. from the University of Michigan and then went to Houston, Texas, where he practiced with Royston and Rayzor for a number of years. Quite fittingly, Judge Brown specialized in his private practice in transportation, maritime and admiralty law.

Interestingly enough, we were chatting this morning, and Judge Brown was reminiscing to me about his own memories of arguing cases before the Interstate Commerce Commission.

He was appointed to the Fifth Circuit by President Eisenhower in 1955 and became Chief Judge of the Fifth Circuit in 1967, a position that he held until 1979. He is now a Senior Judge of the Fifth Circuit, is still very active and has been a participant and, indeed, an author of a number of key decisions involving review of decisions of the interstate Commerce Commission.

It is a very great pleasure to me to be able to present to you, Judge John Brown.
EARLY ADMINISTRATIVE LAW DEVELOPMENT

JOHN R. BROWN

JUDGE BROWN: Thank you very much, Betty Jo, and ladies and gentlemen.

Since this happened to me at the hands of Page Keaton, a revered dean of the University of Texas Law School, and many of you will know him, and I know Betty Jo has very fond memories of him, I'll say this introduction. These proceedings remind me of the man who went to a bullfight, and outside of the arena there was this man dressed in a very elaborate embroidered bolero jacket and a little tricornered hat. The man said, "You are the toreador?" "No." "Are you the picador?" "No." "Are you the matador?" "Well, if you're not the picador, the toreador or the matador, what are you?" He said, "I'm the man who opens the gate and lets the bull come in."

One other thing. This man on judgment day crawled out of his grave, looked at the epitaph and said, after reading it, "Either somebody is an awful liar or I'm in the wrong hole."

I was called on first today because either by the act of the printer in putting my name up first on the left-hand side, Betty Jo's decision, or because I don't know very much about this subject. I just simply have the power to rule on it.

I'm going to count on, and I'm going to leave as much time as we possibly can for, these distinguished gentlemen who are well-informed.

I think we shall be very grateful, and you people who have made your professional livings in the practice of or being on or working with the Interstate Commerce Commission, should be very grateful for this great institution and the wisdom of Congress in establishing it, because I can say that it is really the daddy, I think, of administrative law. I have to leave to my
colleagues, and especially the professor, to tell me to what extent the Commission's actions themselves have been innovative in administrative matters.

But administrative law, as it is today, has largely developed as a result of appeals from the actions of the ICC, and the actions of judges and courts, particularly the Supreme Court on that subject. We know that that has been a very fruitful source of the development of administrative law.

Indeed, there is another very great fact — that there is a continual opposition on the part of the bar to administrative agencies. I must confess that I shared this view when I went on the bench. I had the idea that all administrative agencies were simply tools of the government and, thus, very biased in their outlook. It wasn't long until I could see that the country could not survive without them and, contrary to my bar like impressions, that they are not a biased, partial group of government enforcers. They were there to do a very good job.

Now, as Betty Jo told you, I had the experience of appearing before a division of the Commission in one of these formidable hearing rooms next door. All I recall about it is that they said, "Mr. Brown, you're out of time."

I got into ICC work because I was primarily a maritime lawyer, and at a relatively late date in the regulation of transport matters, they enacted Part III on water carriers. Well, I soon sensed that one of the problems about the administration of Part III on the part of the Commission was that they were uninformed on maritime matters. So I got in a case once in which we got permission from steamship carriers on the Great Lakes to take over their case before the Commission on the carriage of automobiles on the decks of empty vessels or barges. There is a little provision in the Interstate Commerce Act, I think it was Section 303 or something like that, it said nothing in this Act shall prevent a carrier from augmenting or adding to its fleet or its facilities as may be necessary to meet the needs of its shippers.

Well, it seemed to me that one of the things the Commission needed to know about was the practice in the steamship trade of chartering, that's leasing vessels. So I had a friend who was a vice president of a major steamship company, also a lawyer by training and education, and we were having a hearing before a hearing examiner. Unfortunately, the night before there had been a big snow in Washington, and as we came into the hearing room, I noticed this fellow had spats on. I did not know what the impression of the examiner would be to a man wearing spats. I had prepared a great number of photostatic copies of not only charter parties but ocean bills of lading, which showed that in the steamship business, a line carrier, whose fleet was not adequate to meet the needs of the shippers, could lease a vessel, and put it on berth for carriage.

I had this fine expert on the stand with his spats on, very evident, and
I asked him, what does a steamship company, engaged in a liner service, do when they need more bottoms. My opponent objected on the grounds that it interfered with the discretion of the Commission. It was asking a question which was for the decision of the Commission and was, therefore, inadmissible. To which the examiner responded that this is the kind of information we have been needing all these years. He proceeded to hear him at length, and I did get a favorable decision.

It was appealed to the District Court, a three-judge court in Ohio. I appeared there before Justice Potter Stewart, then a judge on the Sixth Circuit, Judge Jones of the District Bench from Detroit, and one other judge. I had reserved one minute of my time to argue. I told the court that I hoped this was my last argument to any court, because I’m on my way to Washington for hearings on my appointment as a United States Circuit Judge for the Fifth Circuit, to which Justice Stewart says, “I wish you well.” And he needed to, because I had some problems.

I repeat again, we’re all fortunate that the ICC came into being and has been so productive in meaningful decisions on the development of administrative law. The studying that I have done in preparing for this sent me back to some very ancient cases, one of which was Interstate Commerce Commission v. Louisville & Nashville Railroad Company in 1912. While it may be an ancient case, it is by no means a dead case. Those of you who are skilled in this field will recall that in Justice Rehnquist, then Justice, not Chief Justice, Rehnquist’s opinion in the Florida-East Coast Railroad case, his primary problem was to deal with this old case. Justice Douglas and Justice Stewart dissented on the grounds that this was, in effect, indifference to the Louisville and Nashville Railroad case by the Supreme Court.

The interesting thing about it is that — I don’t need to review for you what the facts were — in the opinion the Court lists 11 cited cases, all of which, at that time in 1912, were cases that originated in or around or out of actions of the Interstate Commerce Commission. The Court in that case decided some very, very important standards that still are very much alive. They said, for example, “This is a question of reasonable or unreasonable rates. The more liberal the practice in admitting testimony the more imperative the obligation is to preserve the essential rules of evidence by which rights are asserted or defending. In such cases, the Commissioners cannot act upon their own information as would jurors in primitive days.”

Then they said, “All parties must be fully apprised of the evidence that is submitted or to be considered and must be given opportunity to cross-examine witnesses, to inspect documents and to offer evidence in explanation or rebuttal.” In no other ways can a party maintain its rights or make its defenses. In no other way can it test the sufficiency of the
facts to support the findings, for otherwise, even though it appeared that the order was without evidence, the manifest deficiency would always be explained on the theory that the Commission had before an extraneous unknown, but presumptively sufficient information to support the finding.

You see, in contemporary administrative law, a continuation of those principles of a hearing, ordinarily the receipt of evidence subject to cross-examination and testing with an awareness on the part of the parties as to the controlling principles and rules to be followed. What is remarkable, I think, about that was that this was the product of a time when people were violently opposed to this process of administrative agencies, administrative tribunals, and that attitude has not subsided. Indeed, it strives very much. I received within in the last couple of months a copy of the Administrative Law Review with a full treatment of the latest proposal of the ABA section on administrative law written by Professor Levin.

Interestingly enough, there was a comment made earlier about President Roosevelt’s activities in transportation matters, and the remarkable thing was that in about 1940, he himself was very much supportive of an approach that was very critical of administrative law, as it was then practiced. But even since the enactment of the Administrative Practice Act in 1946-1947, there’s been continued criticism of the administrative law system.

Indeed, in contemporary literature, Judge Smith, formerly the Chairman of the Administrative Conference of the United States, wrote an article in, I think in the Duke Law Journal, called “Judicialization of Administrative Law,” and that’s excited a lot of responses which, if they haven’t contributed anything else, have contributed some flowery language. Judge Carl McGowan, for example, in the Duke Law Journal, wrote a reply to judicialization criticizing that approach. Professor Cass of Boston University, wrote an article critical of Judge Smith’s judicialization article, called it “Looking With One Eye Closed.” Then there was “Administrative Discretion: The Gloomy World of Judge Smith,” by Professor Levin and “Twilight or Just an Overcast Afternoon?” by Mr. William Allen, a very active practitioner and a former chairman of the ABA Section on Administrative Law.

Judge Smith’s approach was that we’ve got this thing so refined today that things have become judicialized, and I think there’s a good deal of basis for that criticism. Whether it’s quite as hopeless as he made it out is very doubtful. But I would say that in this rich experience, in which the ICC has been such a principal factor, we have made a lot of progress in administrative law, making it more reliable, and I guess, more consistent with our ingrained notions of judicial fairness and accuracy.

I’ve read a good deal of Professor Davis’ treatises, and I certainly agree with him in several respects, that administrative law has become so
verbalized that it obscures what we are trying to get at. There are all sorts of statutory standards and judge-made standards; substantial evidence, clearly erroneous, clear error, and arbitrary and capricious. What do they mean? Professor Davis is very strong in this view that we ought to just stick to those words and do not let judges try to explain it. I have to agree that when we get through with our explanation, it is not any better than the words that we started to try to explain.

My principal activity as a judge was the 12 years I was Chief Judge of the Fifth Circuit. That is before the practice or review of ICC orders by a three-judge district court was repealed and the present system initiated, where you take a direct appeal to the Court of Appeals. In those 12 years, I had to designate, I think, over 576 three-judge courts. A good one-third of those were ICC appeals. I think real progress was made when the Congress eliminated that superfluous act, since it was essentially a review, as a matter of law, whether the Commission’s design should be sustained, whether the evidence was substantial and all those sort of things. I think the new system is working very, very well, and I must say I think the tendency of judges to intrude on the work of the Commission and the work of administrative agencies is a temptation that is very hard to overcome, and too often, it results in intrusion.

My own experience as a judge started really on three-judge cases. I looked upon the Administrative Procedures Act (“APA”) as a great savior in a couple of early cases right after I went on the bench. I wrote some rather extended opinions in which I criticized the practice of the ICC in those days of suspending some order for good cause shown. I said that under the APA that wasn’t adequate enough. They had to, at least, outline briefly what the good cause happened to be. Here more recently, we’ve had some very important decisions in the Fifth Circuit, one of which sustained in part and reversed in part the decision of the ICC on deregulation of the trucking industry, in which the court said that the Commission’s orders on household goods and bulk carriers was not acceptable.

There was another effort where the ICC, as an outgrowth of deregulation, and I think the Staggers Act, imposed this new standard of geographical competition and commodity competition. The panel first held that that was not acceptable. I dissented rather vigorously, persuaded the court en banc to take it and the en banc court sustained my view and upheld the Commission.

I think the message now is that certainly we cannot survive in this complex industrialized technological society without substantial assistance of agency regulation and determination. While judges do verbalize too much, we think we have finally gotten a fairly workable set of principles that assure, at least nominally, some fundamental fairness to the proceedings.
Professor Davis makes an interesting sort of an insistence that if courts only imposed on themselves the kind of exactitude they impose on administrative agencies, our decisions would be much better. He has written quite an article at the University of Minnesota on how the Supreme Court could well utilize this sort of technique, but he points out that the real difficulty with the court system is that, in these matters, we do not have the factual basis for a sound decision nor do we have the facilities to get it without violating all of the cherished notions and traditions of absolute independence. Which leads me to make this general remark. You know, we exist by virtue of Article III, and the benefits to the federal judges is that they cannot reduce our income. Unfortunately, it does not guarantee an increase either.

As I said, we are the product of Article III. I have long had a great deal of doubt about whether Article III and the case or controversy, which is part of our ingrained view that it's got to be a live controversy and only the parties to that controversy can control it, produces good results. So often, in my experience as a judge, the people who are advocating a position are incompetent to begin with. They do not understand the problem. They have not done adequate research, and they do not advance the most telling arguments. So that too often, law is made by people who are both inept, maybe ignorant and ill equipped to carry it on. That's one of the great advantages, I think, of administrative proceedings. It does allow the agency to marshall all of this evidence, collect a lot of evidence, and then a court gets to review it using one standard or another.

I want to acknowledge my indebtedness, both to Congress for having the wisdom, at a time when it must have been very, very radical to create the Interstate Commerce Commission and its continuing insistence of giving it adequate powers to meet changing conditions.

I've very happy to have been here and to have been invited to be here.

Thank you so much.

MS. CHRISTIAN: Thank you very much, Judge Brown. You yourself have made enormous contributions to the development of administrative law, and I think we are very fortunate to have had you with us today and to be on this program.

Our second speaker is someone that will be familiar to a great many of the people in this audience, since he has been practicing before the ICC for over 30 years.

Joseph Auerbach received both his bachelor's and his L.L.B. degrees from Harvard, served briefly as an attorney with the Securities and Exchange Commission and in the United States Foreign Service, and, in 1952, joined the law firm of Sullivan & Worcester in Boston, where he
began his career as a transportation lawyer actively practicing before the ICC.

For those of us who were here in the 1960's, I think that Joe Auerbach became almost synonymous with railroads and reorganization, since he was involved with both the Penn Central and the New Haven. This was the era in which I myself first had the chance to become well acquainted with him, and in my mind, he will always be closely identified with the successful reorganization of those two roads.

Mr. Auerbach is now of counsel to his firm, and he is, in addition, teaching as a professor of business administration at the Harvard Business School, is one of our outstanding ICC practitioners, and it gives me great pleasure to present Joe Auerbach.
MR. AUERBACH: Thank you very much, Betty Jo.

You are going to see as I go through my remarks, that I have had occasion to plow some of the same fields that George Chandler did this morning, but from a different perspective. His has been history and mine is to try to winnow out the administrative law significance of this.

I would like to start by referring you to a book that many may have read, it won a Pulitzer prize last year, called “Prophets of Regulation,” by Thomas McCraw.

In it he says this:

"From our own perspective, a century later, the greatest significance of the 1887 Act to Regulate Interstate Commerce lies in its creation of the prototypical federal regulatory agency."

The ICC served, of course, over the next half century from its creation, as a model of how the American system could effectively carry out its unique system of federal regulation, administratively, rather than judicially.

Public policy, even in an essentially populist era, with rudimentary local communication, demanded this. The genesis of the public policy lay in the significance of railroad transportation to the fastest growing nation in world history. The railroad dominated this country’s economy and society in the 19th century. The domination existed from every standpoint, capitalization, employment, community impact or entrepreneurial opportunity. There was no force, industrial or religious which matched the societal impact of the railroad after the first third of the 19th century. Before the Civil War, there were already mature rail networks in the East — the
New York Central, the Pennsylvania, the Baltimore & Ohio, the Erie. These actually crisscrossed in this Middle Atlantic area, and by that time, had also opened up the West. After that war, in only the five years between 1868 and 1873, some 30,000 miles of new track were laid.

A little history. The first railroad regulatory commission was in Rhode Island in 1839, and it was followed by New Hampshire and Connecticut, but these acted essentially solely in working out in intermediary fashion joint schedules and rates. In 1869, Massachusetts produced a disclosure statute which provide a true regulatory, investigatory and thus, finally, a true regulatory foundation.

In 1871 and later, as you’ve heard from George Chandler, Illinois, Wisconsin, Minnesota and Iowa passed what we call the Granger laws. These were designed to regulate railroad rates within their borders. These were upheld by the Supreme Court in 1877 on the concept that the states were dealing with an industry affecting a public interest.

Then came the movement from state to federal regulation. It was recognized that state lines bore no rational or necessary economic relationship to actual rail operation or the impact of the rail operation on a state’s economy.

In 1886, however, in the *Wabash v. Illinois* case, the Supreme Court ruled the states could only regulate commerce within their own state. That’s 1886. The consequence one year later is that we have federal regulations so triggered by the Act to Regulate Interstate Commerce.

Conceptually, the birth of this administrative law was a troubled one. I would say more of a Caesarean section than a natural birth. The Commission has only one parent, and at that time, a very cautious one — Congress. There were many foster aunts and uncles in the industry, and while they urged the promulgation of a statute, they considered the concept a considerable nuisance.

But importantly, and most importantly, there was an older, stronger, competitive cousin, the Judiciary. This Act was then viewed as something that was either being carved out of the Judiciary or was in some way in conflict with it.

Nevertheless, the infant was born and it became, very shortly, a creature that showed sagacity and quick growth.

It is extraordinary to note that by the time this infant was 55 days old, administrative law had taken on a meaning. Now, you couldn’t have predicted it, even one year before. And that led me to look at a book that was written that same year, 1887. Many of you know Edward Bellamy’s "Looking Backward."

The reason I looked at it was to see whether Bellamy had any concept of what was going on in this area. It is a book in which the principal
character finds himself — after sleeping in a Rip Van Winkle fashion — awake in 1987. Bellamy is predicting how we would look in 1987. He finds that 100 years later there are new societal relationships, women's rights, federal preeminence, piped music and something he calls "credit cards." Now, Bellamy's predictions which are so extraordinary and so interesting, however, fail in one respect: He never realized what was happening to our judicial system through the emergence of administrative law.

I think a fair conclusion is that Bellamy would be very much surprised by what happened in this area, though, clearly not surprised by what happened in these other areas to which he had reference.

The Commission's administrative law activities have occurred in two principal areas. There are the ICC's own rules and practices, which we can catalog as procedural. Then there are the effects of judicial and legislative acts which have had a substantive consequence in administrative agency functioning. Let me call those the regulatory standards.

I start with the procedural standards.

The 1887 Act contained a term, "full hearing." In those rules of practice which were issued just 55 days after the Act was passed, the Commission, chaired by that noted judge and scholar, to whom George earlier referred, his great-great-grandfather, Thomas Cooley, interpreted this term in their rules as requiring a full oral trial type hearing. This established, procedurally, the kind of due process that was consistent with our common law heritage. But this insistence upon a traditional hearing did not mean that they would ape judicial practice in how the hearing was going to be conducted.

There was very early recognition in the rules — as early as 1887 — that there were to be significant differences in the formalities to be observed by each of the two systems. As early as 1892, the ICC reported, "This endeavor to adjust differences between carriers and shippers without formality, delay or expense has been attended with very satisfactory results."

The Commission instituted during that period the use of prehearing conferences which were designed to induce and encourage settlements informally.

By 1901, the great majority of complaints before the ICC were disposed of by conferences with shippers and carriers or by correspondence. The concept of paper proceedings as an administrative substitute for even the informal oral hearing had become a reality in less than a decade.

The oral hearing also took on a unique form with respect to evidentiary rules. In its 1908 annual report, the Commission stressed, "it is per-
haps not too much to say that not a single case arising before the Commission could be properly decided if the complainant, the railroad and the Commission were bound by the rules of evidence applying to the introduction of testimony in courts."

This conclusion was honored by an unwillingness at the Commission and at its subsequent numerous regulatory agency progeny, which we became familiar with in the 1930s, to exclude any evidence which appeared pertinent, no matter its character or source. Clearly, hearsay rules were not to be observed, and all evidence was to be approached essentially from the standpoint of its weight.

This, of course, was a natural consequence of an expert applying experience and sophistication to facts and opinion rather than barring information because the trial body — including the jury — could not subjectively fairly appraise its significance.

The '87 Act did not prescribe rules governing agency practice. The Commission, therefore, began its existence, not only free of procedural judicial accretions of the past but designedly left free by Congress to adopt rules of practice deemed responsive to the exigencies of its mission.

From the beginning, the Commission fashioned its rules to achieve a simplicity in practice which set a model for future administrative agencies, and to some degree, as I think Judge Brown’s comments today would indicate, for the courts themselves.

The Commission waived requirements of strict adherence to technical rules of pleading so long as complaints were reasonably clear. It discouraged motions to dismiss. It allowed liberal use of supplemental and amended complaints. It freely granted petitions for intervention.

As the Commission declared in its first annual report, "It has been deemed exceedingly desirable that proceedings before the Commission should be made as informal as should be consistent with order and regularity and that dilatory action of every nature should be discouraged."

In numerous decisions during its early years, the Commission made clear that it "was not a judicial tribunal, restricted by technical rules".

Congress had authorized the Commission in the 1887 Act to conduct its proceedings in such manner as would best "conduce to the proper dispatch of business and to the ends of justice."

Early on, the Commission interpreted this mandate very liberally. It adopted rules designed to provide maximum flexibility and efficiency and to make the Commission accessible to the public. In its 1908 annual report, the Commission made an extraordinarily important observation from an administrative law standpoint. "The ordinary court determines only the
rights of the parties before it, but every decision of the Commission involves the rights of parties who are not present before it."

In advancing this proposition, the Commission declared three years later that it was not within belief that Congress intended to convert this Commission into a tribunal which should merely determine, as between two sides, the preponderance of evidence and base its decisions upon technical and somewhat archaic rules. However, the ICC encountered substantive difficulties during this period.

In a series of definitive decisions in the late 1890s, the Supreme Court severely limited the scope of the Commission’s authority under the 1887 statute. It specifically held the Commission lacked the power to fix rates and to enforce the long and short-haul provisions of that statute. By 1897, Mr. Justice Holmes commented that the Court’s rulings had gone "far to make that Commission a useless body for all practical purposes and to defeat many of the important objects designed to be accomplished by Congress." *ICC v. Alabama Midland.*

In its annual report for 1897, the Commission similarly stated that although it would continue to conduct investigations and "perhaps correct in a halting fashion some forms of discrimination, by virtue of this judicial decision, it has ceased to be a body for the regulation of interstate carriers. The people should no longer look to this Commission for protection which it is powerless to extend."

At the urging of shippers and the Commission itself, however, Congress took steps in 1906 to reestablish the ICC as a strong regulatory agency. It then enacted the Hepburn Act, to which George also referred.

From an administrative law standpoint, the Hepburn Act was of immense significance. It made the Commission’s rate orders presumptively correct and immediately enforceable, though subject to being set aside by court injunction. But the burden of proof in rate proceedings was shifted from the Commission to the railroads. This legislation, along with other subsequent enactments expanding their jurisdiction and power, had several important and lasting administrative law effects. The Commission, as a consequence, established the use of hearing officers and developed hearing bureaus. These had become necessary in part because of the increase in the volume of the Commission’s caseload.

The Hepburn Act had authorized employment of special examiners to administer oaths, examine witnesses and receive evidence. This was a step forward in administrative law. And early in 1917, or about ten years later, the Commission inaugurated the significant practice of having the hearing examiner prepare a proposed report in the more important cases. This afforded parties an opportunity to file exceptions and bring forth their best analysis of the record and the law as seen by the hearing officer.
That, in turn, protected both the Commission and the public by narrowing issues and disputes.

Jurisdictional issues had surfaced as early as 1907 in *Texas & Pacific Railway v. Abilene Cotton Oil*. The Court held there that the judiciary had no power to determine the reasonableness of rates in the first instance. This established the doctrine of primary jurisdiction of the administrative agency, which was to have a significant bearing on the development of administrative law.

Following enactment of the Hepburn Act, the Court also narrowed voluntarily the scope of judicial interference, restricting review to the consideration of purely legal and constitutional issues.

This new approach was first articulated in 1910 in *ICC v. Illinois Central*. Recognizing the benefits of Commission regulation, the Supreme Court held that courts must confine their review to questions of power and right and not to matters which could be left to the administrative discretion of the Commission.

As the Court made clear, a reviewing court should not usurp administrative functions by setting aside a lawful administrative power because of its doubts as to whether that power had been wisely exercised. Rather than asking itself whether it would have entered the same order, the Court was required to recognize that the power to make the order and not the mere expediency or wisdom of having made it is the judicial question.

Discretion of the courts was stated with even more precision in 1912 in *ICC v. Union Pacific*. The Court said here, the findings of the Commission were to have ascribed to them the strength due to judgments of a tribunal appointed by law and informed by experience. The courts, therefore, were not to substitute their judgment for that of the Commission on questions of fact.

Here lay a fundamental tenet of administrative law: The clear enunciation of the principle of the respective and distinct functions of court and agency. If the courts were permitted to adopt a factual judgmental review, the advances of administrative law would be lost. The Commission would become, as there stated, a mere instrument for the purpose of taking testimony to be submitted to the courts for the ultimate action.

The principles of administrative law which I have noted, and indeed, many others which were fathered by the ICC were ultimately embodied in the Administrative Procedure Act. Judge Brown has referred today to that statute.

In the view of some commentators, the APA virtually codified the scope of ICC practices and procedures. As one practitioner noted two years after passage of the APA, "everyone interested is still searching in vain for some profound effect that the APA has had on practice before the
Commission." It may be fairly said that the ICC’s rules were virtually a working model.

In conclusion, it’s fair to say that notwithstanding the vicissitudes of history and relationship between the administrative agency and the courts, the ICC has left a lasting imprint on the development of administrative law in the United States and that the principles which it authored, literally, from the promulgation of its rules of practice in 1887, together with the issues which it raised over the next half-century were far broader in their significance than the confines of transportation regulation.

MS. CHRISTIAN: Thank you, Joe, and I think that if anyone had any doubt as to the influence of the ICC on the development of administrative law in general, you have certainly put them to rest.

Our next speaker is a man who had an enormous influence from within the Commission on the development of administrative law during the last decade. Gary Edles received his Bachelor’s Degree from the City University of New York and his LLB from NYU, also holds a Master of Law and a Doctor of Judicial Science from George Washington Law School.

He is the co-author of a book entitled “Federal Regulatory Process, Agency Practice and Procedures.”

After serving briefly with the Civil Aeronautics Board, Gary came to the ICC in 1980 as Director of the Commission’s Office of Proceedings and served as Director of that office during the period when the move toward deregulation was just beginning to move into full flower.

He is now an Administrative Appeals Judge at the Nuclear Regulatory Commission, and I have great pleasure in presenting to you the Honorable Gary Edles.
THE ICC HEARING PROCESS: A COST-BENEFIT APPROACH TO ADMINISTRATIVE AGENCY ALTERNATIVE DISPUTE RESOLUTION

GARY J. EDLES*

I sincerely appreciate the opportunity to participate in this landmark event in the history of the federal administrative process. Whenever one gets to be 100, people ask the same question: "To what do you attribute your longevity?"

Without getting into a discussion of the pros and cons of the ICC's regulatory accomplishments over the years, I think it is fair to say that one reason for the ICC's longevity is its ability to adapt to the real and perceived needs of the various constituent groups to which it is responsible — the Congress, the President, the courts, shippers and passengers, the various industries it regulates, and, ultimately, the taxpayers who must pay the bill. I believe that the development of the ICC's adjudicatory process, including, particularly, the creation of Modified Procedure, is a good administrative law illustration of the ICC's adaptability, in keeping with the theme of our forum, namely, Administrative Law and the ICC — their Evolution.

As most of you know, probably better than I, when Modified Procedure is employed, sworn statements and verified memoranda replace the usual oral testimony and cross-examination offered at a conventional hearing. Instead of cases being decided by individual administrative trial

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judges, they are processed by a cadre of somewhat anonymous lawyers in the ICC's Office of Proceedings, and result in opinions signed, until recently, by three-member staff boards and, now, by the Commissioners themselves. They are a prototype of institutional decisionmaking. When I served as Director of the Office of Proceedings in 1980 and 1981, we had a caseload of about 8000 contested adjudications a year. That kind of workload would have ground to a halt if each case were handled in an individual trial — at least in the absence of an enormously expanded cadre of administrative law judges.

The original Act to regulate commerce of a century ago\(^1\) had virtually no reference to hearings as a mechanism for decision. The ICC was simply instructed to conduct its affairs in a manner conducive to the proper dispatch of business and to the ends of justice.\(^2\) It was Judge Cooley and his colleagues in the 19th century who decided to transplant the courtroom model into the administrative arena. But by the time Congress enacted the Hepburn Act in 1906, it used the term "full hearing" to describe the judicialized procedures that had evolved at the Commission.\(^3\) The ICC's creation of the modern administrative hearing in the 19th century is, of course, itself a significant contribution to the federal administrative process — to say nothing of the contribution it makes to the financial well-being of those of us who make a living from administrative adjudication.

You may be surprised to learn that Modified Procedure is almost as old. The Commission first used it in 1923 to handle an increasing workload of railroad complaint cases. It was then called "Shortened Procedure."\(^4\) In the 1920s it was a purely voluntary scheme. The Commission used it only when the parties agreed. But once they agreed, all issues were decided on the basis of written submissions. As far as I can tell, the parties agreeing to the Shortened Procedure simply made a determination that it made more sense to resolve all outstanding issues without a full-blown trial. In one of its earliest cases, the Commission explained that the new procedures were designed to save time and money for all the interested parties, including the Government, and to effect a more prompt determination of issues.\(^5\) It was, I submit, a very early effort in the administrative arena to use what has become popularly known in the last decade as "alternative dispute resolution."

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1. 24 Stat. 379 (1887).
2. Id. at 385 (section 17).
By the 1930s, the Commission was handling about one-third of its
docket of formal cases through Shortened Procedure.\(^6\) Over time, the
process evolved into Modified Procedure in somewhat the form we know
it today — that is, a procedure where, even without the parties’ formal
consent, undisputed matters or those not involving so-called material
facts are processed in writing, and live testimony and cross-examination
are reserved for controversial issues.\(^7\) In the 1950s, the Commission be-
gan to use Modified Procedure in all types of proceedings\(^8\) and it became
extensively employed in motor carrier operating authority cases starting in
the 1960s.\(^9\)

The standard reflected in the Commission’s rules for deciding when
to hold regular hearings or when to use Modified Procedure was fairly
conventional. Unless material facts were in dispute, oral hearings were
not held for the sole purpose of cross-examination.\(^10\) And, anyone seek-
ing an oral hearing had to explain why the evidence to be presented
could not reasonably be submitted in the form of affidavits.\(^11\)

But, despite that nominal standards, what the Commission actually
did was to employ a form of cost-benefit test to determine whether a trial
or Modified Procedure should be used in a given case. As the system
operated, at least in connection with motor carrier applications in the late
1970s when I first came in contact with it, the Chief Administrative Law
Judge and the head of the Operating Rights Section of the Office of Pro-
ceedings would jointly decide which cases would go to hearing and
which would be processed under Modified Procedure. There was little or
no effort at that threshold stage to determine whether material facts were
actually in dispute. That kind of analysis just was not practical from a day-
to-day management point of view. Instead, the two staff officials made a
sort of “cost-benefit” evaluation to decide which cases should be han-
dled under which procedure. Generally speaking, big cases, that is,
where the authority requested was substantial or where there were lots of
opponents, went to hearing, and smaller cases, by and large, were han-
dled under Modified Procedure.\(^12\) But if the judges’ caseload was a little

\(^6\) IV Sharman, supra note 4, at 226.
\(^7\) See Chicago & E. Ill. Ry. v. United States, 43 F.2d 987 (N.D. Ill. 1930).
\(^8\) Fair and Guandolo, Transportation Regulation 326 (7th ed. 1972).
\(^9\) Hardman, Modified Procedure in General, 1972 Transportation Law Institute, Practice
and Procedure Before the Interstate Commerce Commission 104.
1972).
\(^12\) The Commission has acknowledged this approach. See 45 Fed. Reg. 86,771, 86,777-
78 (1980). So has its staff. See King, Types of Procedures Followed by the Commission and the
Factors Determining Choice, 1972 Transportation Law Institute, Practice and Procedure Before
the Interstate Commerce Commission 73-77.
light in any given month, a few more cases were added to the oral hearing
docket. On the other hand, if the Office of Proceedings staff had a little
extra time, a few more cases were thrown on the Modified Procedure pile.

I later learned that the Commission had invented a separate mecha-
nism for ensuring that these threshold management decisions did not run
afoul of the "material fact in issue" standard contained in the Commis-
sion's regulations. As sophisticated ICC practitioners are aware, if a los-
ing party took a case to court following a Commission decision, the Office
of the General Counsel scrutinized the decision to see if it was defensible.
Among other things, it looked to see if the Commission had used Modified
Procedure where facts were actually disputed and turned out to be mate-
rial. If it had, the General Counsel, after clearing it with the Commission,
asked the court simply to return the case to the Commission for more
traditional disposition.\footnote{The technique is still in use. See Lakeland Bus Lines, Inc. v. ICC, 810 F.2d 280, 283-84 (D.C. Cir. 1987).}

Thus evolved a \textit{de facto} consensual form of alternative dispute reso-
lution for most ICC proceedings. Given the tens of thousands of adjudica-
tions processed over the decades, and the very high percentage handled
by Modified Procedure, I have no doubt that the Commission basically
decided most issues, including issues of fact, without a conventional
hearing. But it was all done, in effect, with the acquiescence of the parties
— if we assume that a failure to seek judicial review manifests at least an
acceptance, if not an endorsement, of the Commission's ultimate decision
in a given case.

The Commission's approach over the years has been generally ap-
proved and applauded. When the Attorney General's Committee on Ad-
ministrative Procedure surveyed federal agency operations in 1941 as a
prelude to its recommendations leading to the adoption of the Adminis-
trative Procedure Act, it pointed to the ICC as an agency at which litigants
were generally satisfied that procedures were fair and unbiased.\footnote{Final Report of the Attorney General's Committee on Administrative Procedure 59-60 (1941).} Indeed, the Committee strongly endorsed "shortened procedures," and
even noted that the use of written statements in some types of cases re-
sulted "in greater precision than where the facts are presented orally."\footnote{\textit{Id.} at 69.}

Judge Henry Friendly, who was one of the more thoughtful analysts
of the administrative process during his tenure as a Circuit Court of Ap-
peals judge, observed, in a 1960s case, that

\begin{quote}
[\textit{I}the Commission's modified procedure is a commendable effort to limit
hearings to those cases and even those witnesses where an oral hearing is
\end{quote}
essential to fairness.\textsuperscript{16}
And I think it is accurate to say that the Commission’s decisional process, including its reliance on Modified Procedure, has been, by and large, accepted by the Practicing Bar.\textsuperscript{17}

As some of you may know, before coming to the ICC in 1980, I spent 13 years in the Office of the General Counsel of the Civil Aeronautics Board. Back at the CAB in the late 1970s, we were looking around for a means of handling more applications and expediting the licensing process. Historically, the CAB had held only conventional hearings in all cases and had no counterpart to Modified Procedure.\textsuperscript{18} But the CAB operated under the identical licensing scheme as the ICC, because the Civil Aeronautics Act of 1938 was modeled on the Motor Carrier Act of 1935. And Modified Procedure was a tried and true form of handling transportation licensing cases.

So, when the CAB put together its expedited hearing procedures in the late 1970s, we naturally used Modified Procedure as the model. We made only one principal change. Rather than employ the “material issue of fact” standard that was included in the ICC’s rules, we attempted to fashion a cost-benefit criterion that we believed to be the practical governing standard applied by the Commission.

The CAB’s rule, as it evolved, provided for conventional hearings only when “material issues of decisional fact [could not] adequately be resolved without oral evidentiary hearing procedures,” or when “use of expedited procedures would prejudice a party,” or when oral hearings were “otherwise required by the public interest.”\textsuperscript{19}

The CAB’s expedited procedures were never challenged in court, because the Airline Deregulation Act specifically approved the CAB’s approach and the airline industry essentially acquiesced in the deregulation of domestic air transportation.\textsuperscript{20}

But, when I came to the ICC in 1980, one of our first projects was to develop an even more expedited licensing process for motor carrier cases. Congress, after all, was getting ready to impose statutory deadlines as part of the Motor Carrier Act of 1980. What seemed clear was

\textsuperscript{17} But see, Hardman, supra note 9, at 122-24 (many lawyers believe Modified Procedure is not as fast, not less costly, and does not result in full disclosure of the facts).
\textsuperscript{20} The CAB’s approach was an acknowledged effort to move beyond the traditional “material facts in issue” criterion for granting conventional hearings. See 43 Fed. Reg. 19,403, 19,408-11 (1978). In the Airline Deregulation Act of 1978, Congress eliminated the traditional statutory hearing requirement and specifically endorsed the CAB’s expedited procedures. See 44 Fed. Reg. 11,364 (1979).
that Congress would demand elimination of the case backlog and was going to require very speedy handling of all new motor carrier applications. Increased emphasis on Modified Procedure seemed the only way to go.

The Office of Proceedings staff, using its reservoir of experience, developed an even more efficient Modified Procedure designed to comply with Congress' requirement that all motor carrier license applications be processed within six months. Adoption of the "case-in-chief" format was a major aspect of the new procedures. As part of those procedures, though, the Commission also decided to adopt, in terms, the criteria for conventional hearings that the CAB had adopted the year before.²¹

This time the procedure, including the new standard, was challenged in court. And, in an opinion written by Circuit Judge Brown, the Fifth Circuit found it to be consistent with the requirements of the Motor Carrier Act of 1980.²² Thus, the cost-benefit balance, which started out as a de facto but not de jure element of the ICC's adjudicatory approach, and which gravitated to the CAB in the late 1970s, became a formal element of the ICC's adjudicatory process in the 1980s.

Now, the cost-benefit balance has become a popular analytical tool in the administrative environment of the 1970s and 1980s. In 1976, for example, in the case of Mathews v. Eldridge, the Supreme Court adopted the approach to determine what kind of hearing, if any, is necessary to protect individual rights under the U.S. Constitution.²³ But the approach has not really been explicitly approved across-the-board where administrative hearings are required by regulatory statutes.²⁴ Alternatives to conventional hearings are only now slowly finding their place in the arsenal of procedures used by federal administrative agencies.

Professor Kenneth Culp Davis argues that

[t]he tendency of courts, aided and abetted by practitioners, has been to refuse to recognize any middle position between requiring a trial-type hearing and not requiring it.²⁵

The ICC's use of Modified Procedure over the years is a happy exception to the Davis rule. Although it hasn't always prevented backlogs,

²² American Transfer & Storage Co. v. ICC, 719 F.2d 1283 (5th Cir. 1983).
²³ 424 U.S. 319, 335. See Sutton v. City of Milwaukee, 672 F.2d 644, 645 (7th Cir. 1982), explaining that Mathews v. Eldridge is "a simple cost-benefit test of general applicability."
²⁴ Perhaps the most far-reaching judicial approval of a type of cost-benefit approach was the District of Columbia Circuit's en banc decision in United States v. FCC, 652 F.2d 72 (1980). The court endorsed an FCC determination that it was in the public interest to allow new entrants into the domestic satellite communication industry without holding an evidentiary hearing, despite the express statutory hearing requirement in the Communications Act.
and has had its critics from time to time, it has produced an expeditious means of handling a large administrative caseload that is generally fair and, just as important, is perceived as fair. It was a cost-benefit approach to alternative dispute resolution long before either of those notions had become popular. And those of us who have been involved with the procedures — whether from the inside as government lawyers or the outside as private practitioners — should recognize that we have played a role in a unique and successful experiment in the evolution of the federal administrative process.

MS. CHRISTIAN: Thank you very much, Gary.

Our final speaker on this panel is one of the foremost academic authorities on administrative law in this country, Professor Victor Rosenblum. Vic received his AB and LLB Degrees from Columbia and his PhD from the University of California at Berkeley. He has taught both law and political science.

He served as President of Reed College from 1968 to '70 and has been a professor of law in political science at Northwestern since 1970. Since 1979, he has also served as Director of the Law School Graduate Studies Program at Northwestern.

Vic is very active in the Administrative Law Section of the American Bar Association and also in the Administrative Conference of the United States.

It is my great pleasure to introduce Professor Victor Rosenblum.
MR. ROSENBLUM: Thank you so much, Betty Jo. It is a great privilege to be a participant in this Centennial celebration for the Interstate Commerce Commission.

In all of the remarks of the panelists after the keynote address by Mr. Miller, we have heard references to the creativity, the initiative, the efficacy, and the fairness of the contributions made by the Interstate Commerce Commission.

I have to confess a bit of surprise that the keynote address was an invitation to a wake rather than a celebration of a hundred years of achievements which might still have some contributions to be made in the future.

Instead, we were told that the Interstate Commerce Commission has no redeeming public benefit, that we can expect no more of it, that it should be allowed to die with dignity, and that we should gather here at some unnamed time in the future for a fantastic wake.

Somehow it seems to me that it might not have been inappropriate for the issue of the role of a representative of the White House to have been dealt with in ways in which that issue was dealt with in the past of the ICC. It was suggested on these occasions that the White House did not have a key role to play in the determination of the role or the future of the agency, but that any determination concerning an independent regulatory commission was to be made by legislation. Beyond that, both the Legislature and the Executive had to butt out.

If one looks at the remarkable exhibit next door that has assembled documents of the past history of the Interstate Commerce Commission,
one finds included in those superb materials remarks that were made by
the Honorable Joseph Bartlett Eastman in 1944 on the occasion of his
25th anniversary as a Commissioner of this distinguished agency. The
entire remarks published under the heading of the "12-Point Primer" that
he proposed are worthy of reading, but let me summarize some of the
points made by Mr. Eastman in that vital document.

He said:
"With a country as big and complex as it is, administrative tribunals like the
Interstate Commerce Commission are a necessity. To be successful, they
must be masters of their own souls and known to be such. Political domina-
tion will ruin such a tribunal. "Good men," he said, "can produce better
results with a poor law than poor men produce with a good law."

And finally, he noted: "Zealots, evangelists, and crusaders have
their value before an administrative tribunal but not on it."

Those observations are well worth noting, even in our own time, for
much of the talk that is directed toward issues of deregulation has, I would
suggest, some implicit inaccuracy, if not deceptiveness in it.

I am not an opponent of deregulation as such, but much of what has
passed for deregulation within our society in recent years has not been
ture deregulation so much as it has been the triumph of one form of regu-
lation over another.

It was noted by our colleagues that this morning the spring meeting
of the Antitrust Section of the American Bar Association is taking place in
another part of town, and that is a vital and thriving meeting. I suggest to
you that part of what has been called deregulation in the last few years
has represented more of a substitution of an antitrust approach to regula-
tion for the approach of regulation by administrative agencies. Yet the
governmental hand in regulation by antitrust is as present — or perhaps
at times even more present, though perhaps less subject to public ac-
countability — than it is when the authority is exercised by a regulatory
entity.

Judge Brown referred quite carefully and thoroughly to some of the
examples — and Joseph Eastman, in his prime, and Gary Edles, this
morning, referred to even more — examples of the creativity of the contrib-
utions made to administrative law by the Interstate Commerce
Commission.

To my mind, one of the most salient of the contributions made by the
ICC was made within the realm of this vital doctrine of primary jurisdiction,
a doctrine which at times had led the Supreme Court of the United States
to say to the Antitrust Division, "Keep your hands out of this until the regu-
larly agency has utilized its expertise and experience in suggesting the
ways in which this matter ought to be resolved."

One of the great primary jurisdiction cases was the Western Pacific
case, decided in 1956, with a decision by Mr. Justice Harlan in which he went to great pains to delineate the doctrine and the central role to be played by the Interstate Commerce Commission in its application to the matter of the construction of a tariff.

The Supreme Court was at its best there in a most instructive and constructive opinion on the part of Mr. Justice Harlan regarding the roles of an administrative agency.

Why should there be the assumption that getting rid of the Interstate Commerce Commission, as indeed we have gotten rid of the Civil Aeronautics Board, produces a deregulated society?

Now, you and I are still doing a good deal of traveling on airlines, I take it, and notwithstanding the demise of the Civil Aeronautics Board, I for one find that as an individual flier I am more subject to regulations after the demise of the CAB than I was when it was an active force.

I know that when I fly today I can barely find out in advance what it is going to cost me. The advertised rates are the rates which are usually unavailable unless one gets the ticket more than 30 days in advance and places his marriage in jeopardy by spending every Saturday night away from home.

In the olden days, under regulation, one could buy a ticket that was good on any airline on any day and all of the prices were posted.

I think that before we accept the blandishments of the notion that deregulation really means that we are deregulated, we ought to have empirical data about the consequences of so-called deregulation for the ordinary human being and not simply for a few favored entrepreneurs who are the beneficiaries of the term.

Furthermore, as I have suggested to you, there are serious questions about whether leaving things to the antitrusters will invariably put us in a better position than having us subject to regulation by administrative agencies.

My recent experiences, and perhaps some of yours, with regard to telephone systems are not all that encouraging in that regard. When I pick up my telephone today, I find that I have poorer service at generally higher cost than was the case when Ma Bell was subject fully to the Federal Communications Commission’s regulations. The breakup, which was a breakup that was ordered through the application of antitrust law, may or may not in the long run turn out to have been a wise action.

But it seems to me that it was at least questionable whether the FCC should, as it did in that case, simply withdraw and say, “Oh, we don’t really know whether we have authority on this matter or not, so we will step out for now. It was dysfunctional to bypass the regulatory agency and to leave the matter of the construction of the abundance of telecom-
munications issues that had to be dealt with to an able, but burdened, single judge, who then had to go through nearly a million pages of material in deciding what the outcome of that case should be.

I would urge that we review carefully, as the panelists before me have done, what the history and contributions of this distinguished agency have been. I believe that they have been contributions not merely to the teaching of administrative law, but to our society overall. The ICC contributed to finding ways that can be less formal, more efficient, and can still be fair in achieving results that meet the criteria and the standards of the concept of the public interest.

When my late colleague, Nat Nathanson, and his colleague, Lou Jaffe, wrote their distinguished book on administrative law, they noted especially the significance of the Interstate Commerce Commission. In the course of their fourth edition, which was written in 1976, they stated that “the development of administrative agencies in the United States was attributed to the ways in which the market failed to maximize production or to deliver adequate supplies to those needing them and, indeed, as well was due to the violent traumas of bankruptcy and ruin for many industries. Congress acted in response to the proposition that neither the market mechanism or business administration could adequately protect the social organization. It is customary and appropriate,” said Nathanson and Jaffe — and in this respect they were echoing other casebook writers as well — “It is customary and appropriate to date the present era of administrative regulation from the creation of the ICC in 1887. The Interstate Commerce Commission broke new ground in the federal establishment through its large armory of powers, through its capacity to exercise vetoes on entrance, exit, expansion, consolidation, and merger, through its fixing of rates, its promulgation of rules of service and safety, and its adjudication of alleged rate violations, and its capacity to award or deny reparations to shippers.”

I am not offering an ode to the concept of regulation for regulation’s sake. I am rather suggesting that a history of a hundred years of regulation by an agency concerned with protecting this elusive but vital thing called the public interest should not be quickly dismissed without full analysis of what the consequences will be.

The substitution of an antitrust motif for a regulatory agency motif is at best something which is vastly in need of study.

My antitrust professor at Columbia, Professor Milton Handler, in recent years chose to examine the relationship between administrative regulation and antitrust regulation, and interestingly enough, Professor Handler, in articles, including one in the Yale Law Journal, made the observation that overall there were things to be said for administrative regulation’s methodology that were superior to those of antitrust.
When is there opportunity for public participation? When is there opportunity to know in advance what a policy is going to be under the rubric of antitrust?

Within the realm of administrative regulation, we have developed the capacity to achieve what the framers of our Constitutional system were talking about when they said that "in establishing a government to be administered by men over men the great difficulty lies in this: you must first enable the government to control the governed and in the next place oblige it to control itself."

Within the framework of a hundred years of the traditions of the Interstate Commerce Commission, we have seen key occasions on which this blend has been dramatically demonstrated, the blend of the capacity to regulate, to enable the government to control the governed, and at the same time out of its sense of fairness and out of its regard for Constitutional and statutory principle to oblige the government to control itself.

This is a rare blend. I think we should nurture it rather than prematurely erect funeral pyres and tombstones to it.

Thank you very much.

MR. CLEARY: I wish to thank you all. Being very faithful, I am sure you feel that the last moments have been very worthwhile, and I think the comments of Professor Rosenblum and the other members of this panel have given us a lot to think about.

I hope you can think quickly and we can get a large group back here at 2:00 o'clock, when we have some good events for this afternoon.

Thank you very much.

(Whereupon, the ICC Centennial Celebration was recessed for lunch, to reconvene at 2:00 p.m., this same day.)
MR. CLEARY: In order to keep the program going this afternoon, I hope we can do better on our schedule than we did this morning. I don't know how many of you were so faithful as to stay with us or be with us at the end, but we only finished about 20 after 1:00 on what was supposed to be a noon finish this morning.

I think as you are filing back into your seats I will read to you the greetings to the participants, guests, and friends of the Interstate Commerce Commission's 100th anniversary.

"As Mayor of the District of Columbia, I am pleased to extend warm greetings to the participants, guests, and friends of the Interstate Commerce Commission on the occasion of your 100th anniversary, which is being celebrated on Friday, April 3, 1987. I would like to take this opportunity to commend the participants and coordinators who have worked diligently for this festive occasion. As you celebrate this milestone in your history, I know that the residents can continue to look forward to the services which you provide to this city and throughout our nation. On behalf of the residents of the District of Columbia, I send best wishes for a happy anniversary celebration. Marion Barry, Jr., Mayor, District of Columbia."

So that is kind of the official greeting and welcome from the Mayor.

I also think it is appropriate that we recognize — I should have really said it after Mr. Miller was here because it probably would have brought a pleasant smile to his face — realizing how well the Administration is dealing with budget deficits, one might ask how is this whole thing being funded and how much is the government spending on this celebration.

Well, the fact is the government is spending nothing on this celebration. We even pay to rent this governmental hall; that is, the ICC Planning
Committee does that through the gracious contributions of many sponsors. You will see names in the program this evening.

But what got this off the ground — and I was reminded this morning that, while Fritz Kahn certainly has been at the head of it, one of the suggestions came from Bea Aitchison at a luncheon of the local chapter of the Practitioners, I think it was, a little over a year ago. But Fritz is certainly to be commended.

However, we should mention some of the organizations that we originally contacted to see if they would lend their name in support, circularize their membership, do various acts, including printing stationery, helping on brochures, needless to say, offering time of personnel, and so therefore I would like to list some of those sponsoring organizations of the ICC Centennial Planning Committee: The National Industrial Transportation League, American Short Line Railroad Association, The Association of American Railroads, The American Trucking Association, The Interstate Commerce Commission, The Association of Transportation Practitioners, Transportation Research Forum, National Association of Regulatory Utility Commissioners, Transportation Committee, ABA, Section of Administrative Law, and the Transportation Lawyers Association.

Those are organizations that we have had the privilege of being able to carry on our letterhead in generating support for this event.

So it is good to see you back here this afternoon. I think we have some interesting panels for the afternoon events. They may be a little controversial, maybe not. I hope we at least have the stimulation and good time to commemorate this special anniversary.

The first panel this afternoon is on the Congress and the ICC — the 1980s Legislation, and as the moderator, again we are honored to have a former Commissioner, Daniel O'Neal.

Commissioner O'Neal was a Commissioner at the ICC during 1977 until 1980. He was appointed to the position by President Carter on April 5, 1977.

During his tenure as Chairman, major changes were made at the ICC. Unprecedented administrative changes were accomplished, resulting in substantial deregulation of motor carriers, railroads, buses, and related brokers. Management of agency resources was also dramatically improved.

While Chairman, he was a member of the Board of Directors of the United States Railway Association, and he was first appointed to the ICC in 1977. He was Chairman from the other dates that I gave you, '77 to '80.

Dan is now Chairman of Greenbrier Intermodal, a member of the
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Greenbrier family of companies, and it is a pleasure to introduce him today as the moderator of this afternoon’s first panel.
MR. O'NEAL: Thank you, John.

We have, I think, an interesting group of people here to talk about the ICC and relationships with the Congress, and we are going to focus on 1980s legislation, but we think that it is appropriate and helpful in understanding what happened in that legislation to look back at a little bit of history without redoing what the panel on history did so well this morning.

I was just handed here a few minutes ago by Jack Fryer the latest legislation affecting the ICC. It is a joint resolution passed by both houses of Congress. I am not going to read the whole thing, but I will read the RESOLVED part to let you know that Congress still knows that there is an ICC, and it doesn't always say bad things about the ICC. It goes this way:

"RESOLVED by the Senate and House of Representatives, the United States of America, in Congress assembled, that April 3rd, 1987 is designated as Interstate Commerce Commission Day. The President is authorized and requested to issue a proclamation calling upon the people of the United States to observe that day with appropriate ceremonies and activities to recognize the 100th anniversary of the establishment of the Interstate Commerce Commission."

So that is the latest legislation in quite a bit of history of legislation in just the last few years.

The other panels that you have heard and one that you will hear later today discussing such issues as whether there should be an ICC, the legal functioning of the agency have concentrated on looking at the agency's history. We are taking a little different tack, although we want to spend a little time on history. We will spend less time on the organic
questions of why or whether there ought to be an agency and what it ought to do and concentrate more on the evolving interplay between this important regulatory agency and the Congress.

From my perspective, the foundation for what happened with legislation in the 1980s definitely came from action within the Interstate Commerce Commission.

I can remember very well my first introduction to the agency. I was up on the Hill with the Senate Commerce Committee and had just taken over as Staff Counsel to the Subcommittee on Surface Transportation. We had a brand new subcommittee Chairman, Vance Hartke, who was quite aggressive, and he wanted to make some marks, and one of the first things we decided to do was have an oversight hearing on the Interstate Commerce Commission, and as far as I know, it was the first one that had been held by the Senate at least — the House had done it, but the Senate had not done it for at least 25 or 30 years.

It was at that time that I began to realize just how important and valuable and how excellent the staff and other people and Commissioners at the ICC could often be. The person who instructed me at that time on the Interstate Commerce Commission helped a lot in helping me draft the tons of questions that we threw at the agency was Bob Calhoun.

I don’t know if he ever told the Commissioners the role he played in drafting these questions, but we had a lot of questions. We had the entire membership of the Commission up before the Congress, before the Senate committee, and we went on with questions from the Chairman of the committee for several — well, at least two days.

It was quite an experience for everybody, and I remember one of the things that happened kind of a result of that was that it seemed to me maybe the next legislative session the ICC sent up something like 19 or 20 bills for the Congress to look at, and I went through these bills and thought after giving them some analysis that there was hardly anything in any of these bills that the Interstate Commerce Commission could not do itself, and I had the bad judgment of saying that to a reporter and it showed up in the press, and I was very embarrassed by the whole thing, and I had to personally apologize to George Stafford.

But we had a view, I think, on the Hill at that time that the agency could be doing a lot more than it was doing.

And then in the 1970s, and I would say one of the first important acts that got the Commission going was George Stafford appointing a blue ribbon committee. Ed Reedy was the Chairman. I saw Ed here this morning. I think Bob Burke was on the committee. They came back with a number of recommendations that were eventually adopted by the agency.

When I became Chairman, I appointed George Chandler the head of
a task force, and he came in with 39 recommendations, most of which were adopted by the agency.

Most of these changes, in other words, came from within. The good ideas, the best ideas really, for changing regulation, in my judgment at least, came from inside the agency, came from really dedicated and excellent people who worked in this agency.

As Jack Fryer can relate, if he will — I don’t know if he wants to — we later had — and I guess Will can, too — when I was still here, we got the message from the Hill that we had gone too far and that the ICC, having gone 180 degrees from where it had been, Congress went 180 degrees and said you got to stop this, we are going to do it ourselves.

Everyone up here, at least the five of us involved in this panel, share a somewhat common background. We have all worked in a regulatory agency. We have all worked on Capitol Hill, either as a private individual or as staff members. We have all had a variety of governmental experience, in other words, and I think that brings kind of a unique perspective to the subject matter we are going to try to address today.

I am going to be a little old-fashioned maybe, and I am going to introduce the lady on the panel first. For most of you, I don’t think I need to spend a lot of time introducing her, because I think most of you know Jan Rosenak.

She and John Kinnaird have moved to places in the world that are hard to pronounce and to spell, and I guess it is because in their retirement they don’t want people finding them. I am not sure.

But Jan now lives in Tesuque, Tesuque, New Mexico, which is somewhere near Santa Fe. She characterizes herself as a transportation consultant, and she certainly has the credentials for that. When she left the government, she was Director of the Office of Legislation and Governmental Affairs. She had been Legislative Counsel since 1981.

Before that she was on Capitol Hill as Transportation Counsel for the Senate Commerce Committee during the critical years between September 1979 and September 1981 and during this period worked extensively on the Staggers Rail Act and Conrail legislation. So she was right at the heart of the activity up on Capitol Hill.

And then before that, she worked here at the Interstate Commerce Commission. She was the head of the Rates Division in the Office of Proceedings. She knew everything about rates. She was one of the best advocates within the agency.

She also had been an administrative law judge. She worked for Commissioner John Bush. She worked for Commissioner Howard Friese. She has extensive experience, as I say, and without any further on Jan,
although there is much more to say, I would like to introduce Jan Rosenak.
MS. ROSENAK: Thank you.

I am very pleased to participate in this program today. It is great to see so many old friends and, of course, the Centennial of the oldest regulatory agency is an occasion to celebrate.

The topic of this panel is the 1980s legislation. However, before turning to that legislation, Dan O'Neal asked that I touch on the rationale that caused Congress to decide in 1887 that there ought to be an Interstate Commission.

I am sure that all of you are aware of the background in general terms. The Act to Regulate Commerce, which established the ICC effective in April of 1887, grew out of public agitation and Congressional investigations of rail rates and financing practices. The Granger movement was very active during the 1870's. The farmers complained about discriminatory rail practices and high rail freight rates. A decline in the price of agricultural products made the burden on farmers particularly severe.

In response to problems of this nature, a number of midwestern legislatures enacted fairly extreme railroad laws in the 1870's. A series of Supreme Court decisions generally upheld the validity of railroad regulation, but an 1886 decision, the Wabash case (118 U.S. 557), held that a State could not control rates on interstate traffic. This undoubtedly hastened Congressional action. In addition, it should be noted that the railroads actively supported some type of Federal regulation — to avert the possibility of burdensome State laws.

Actually, numerous bills were introduced in the years preceding passage of the Interstate Commerce Act. Several bills passed the House, but the Senate failed to take action. A Texas Congressman named Reagan
was particularly active. He introduced bills year after year (from 1877 on). In 1884, the House passed Reagan’s bill. In 1885, the Senate passed the Cullom bill (named after Senator Cullom of Illinois). It was at this point that Senator Cullom appointed a select committee to study the matter, resulting in the famous “Cullom Report” submitted in January of 1886 — a report that helped shape the final form of the Act. The Cullom bill, setting up a Commission, passed the Senate. The House then passed the Reagan bill which left enforcement to the courts. Again, the two Houses were deadlocked. But this time a compromise was reached. An Act establishing a Commission was agreed to, and the bill was signed into law by President Grover Cleveland on February 4, 1887.

It should be noted that, by this time, the Granger movement had lost its strength, and competition had forced rail rates down. Thus, discrimination in its various forms was considered the greatest evil at which the bill was aimed. The first Chairman, Thomas Cooley, a law professor and justice of the Michigan Supreme Court, was generally well regarded. The salary of the Commissioners was $7,500, an amount higher than that of all other judges at the time with the exception of Supreme Court members. The first budget was $100,000.

In brief, the legislation as passed required that all rates be “just and reasonable.” Discrimination and undue preference and prejudice were prohibited, and the publication of rates and fares was required, with strict adherence to published charges. Under the long-and-short haul clause, no common carrier could receive greater compensation for a shorter than longer distance over the same line “under similar circumstances and conditions.” (This provision was at issue in many of the early ICC cases). In its final form, the Act was, interestingly enough, to be administered by an independent Commission of five members. Thus, in a sense, the Commission is back where it started — although the rail law it administers today differs substantially from the 1887 legislation.

One of the parties in an 1897 case describes the situation at the time of passage of the Act in the following terms:

At the time of passage, the railway carriers were the absolute and irresponsible masters of all interstate commerce. The several States, in trying to break up, or at least to mitigate the unjust tyranny of these great corporations and combinations that held the largest part of the intercourse of the people in their grasp (and which in many instances undertook to control political as well as commercial affairs) found themselves baffled, and practically defeated in their efforts by the national constitutional provision that only Congress could regulate interstate commerce. In this state of affairs, and to redress such enormous grievances, the Interstate Commerce Act was passed.

As is apparent, feelings were running very high at the time.

A further description of the underlying rationale for the original Act is
set forth in the first annual report of the Commission, dated December 1, 1887:

The Act to regulate Commerce was passed. . . .in recognition of a duty which, though long delayed, had at length, in the opinion of Congress, become imperative. The reasons for the delay are well understood. When the grant was made by the Constitution, the commerce between the States was quite insignificant. . . . On the land, there was very little that could be said to rise to the dignity of interstate commerce.

The report details the circumstances of railroad development. Because of the demand of every city for a railroad, there was substantial overbuilding, and a large proportion of public money sunk in railroads was lost. By the time of the ICC's first report, the Commission noted that 108 roads were then in the hands of receivers. Rate wars and secret rebates are cited.

The memorandum book carried in the pocket of the general freight agent often contained the only record of the rates made to different patrons of the road; and it was in his power to concede a special rate on one day, and to nullify it on the next by doing even better by a competitor.

Similar problems existed in the transportation of passengers. According to the report, the general fact was that those able to pay the most paid the least; for the poor man seldom had any ground on which to demand free transportation, while the rich man was likely to have many grounds on which he could make it for the interest of the railroad company to favor him.

The manner in which corporate stocks were manipulated was referred to as "often a great scandal," and the persons in control of the railroad "amassed great fortunes" in a very short time. This gave the public the impression that these fortunes were unfairly acquired at the expense of the public, and strengthened the demand for legislation.

In closing, the Commission noted that "the Act to Regulate Commerce" laid down certain rules to be observed by the carriers which were intended to be" and emphatically are rules of equity and equality and which, if properly observed, ought to and no doubt will restore the management of the transportation business of the country to public confidence."

Incidentally, the original Act was about 10 pages long. However, the Commission's power was restricted by several early Supreme Court cases, and Congress subsequently expanded the ICC's jurisdiction — first, as to railroads, and later by conferring jurisdiction over other modes of transportation. By the time of the recodification of the Act in 1978, the "green book" had grown to almost 300 pages.

But, by then, we were in a new era. Alternative modes of transportation were available for most rail traffic. The railroads were experiencing serious financial difficulties. This led in 1976 to enactment of the 4-R Act, legislation intended to eliminate unnecessary restraints on competition, through such concepts as market dominance. In addition to more limited regulation, the process itself was expedited. And the Commission was
directed for the first time "to make a continuing effort to assist the carriers in obtaining (adequate) revenue levels."

Despite the substantial nature of the 4-R Act reforms, the legislation was less successful than anticipated, in part because little activity occurred, while many of the major changes, such as market dominance, were litigated.

Further rail legislation became necessary. The Administration introduced its proposal, S. 796, and, following extensive hearings, the Senate and House developed rail bills (S. 1946 and H.R. 7235, respectively). I was with the Senate Commerce Committee at the time. As some of you will remember, in addition to the Congressional hearing process, numerous informal meetings were held with Senate and House staff. There was a consensus that less regulation was desirable. At the same time, a consensus was lacking on certain familiar issues: jurisdictional thresholds; revenue adequacy; maximum-rate provision; joint rates.

Nevertheless, the bill introduced by Senators Cannon, Long, and Packwood was generally favorably received and proceeded through Committee fairly smoothly. Then the trouble began. Certain utilities continued to express concern with regard to coal rates which led to the Cannon-Long controversy on maximum rates. Additional hearings were held; there was intense lobbying on this issue. All efforts at compromise failed until about 30 minutes before the rail bill was scheduled to go to the floor on April 1. At that time, a compromise was reached — the so-called "Long-Cannon Amendment," 49 U.S.C. 10707a(e)(2). With this change, S. 1946 passed the Senate by an overwhelming vote of 91-4 on that day, April 1, 1980.

Another compromise was reached just before Senate floor action. That concerned the joint rate surcharge provision. This issue had been considered during the hearing and drafting process, but specific language was not included in the legislation. Then, Conrail and Southern Railway agreed on a proposal which became a part of the bill. Because not all railroads or other interested parties had the opportunity to study the provision, Senator Cannon offered assurance that appropriate changes would be made as the legislation proceeded to the conference process.

Meanwhile, on the House side, most of the controversy centered on the maximum-rate provisions — and, to some extent, the surcharge provisions. As the bill was reported out of committee, H.R. 7235 provided that the railroads could establish any rate, unless there was no actual or present potential transportation alternative and the rate resulted in a revenue-variable cost percentage equal to or less than the cost-recovery percentage. (Increases were limited to 10 percent a year for two years to ease the transition.)

Shippers did not perceive the House bill as providing sufficient pro-
tection for captive traffic. In addition, there was serious concern by carriers and shippers with regard to the practicality and reliability of the cost-recovery percentage. As on the Senate side, the utilities contended the bill would have a serious effect on coal rates and on conversion.

The House bill came to the floor in early July but action was not completed before the July recess. When consideration was resumed in late July, Congressman Eckhardt offered an amendment substantially changing the maximum-rate provisions. When that amendment was adopted, the bill was withdrawn. Subsequently, during the rest of July and the month of August, various compromise negotiations took place. Agreement was ultimately reached in early September (the Staggers/Rahall/Lee amendment), and the House passed H.R. 7235. Following weeks of conference consideration and approval of the report by the House and Senate, S. 1946 was signed by the President on October 14, 1980 (most provisions were effective October 1, 1980), and the "Staggers Rail Act of 1980" became law.

Since that time, the Commission has been involved in implementation of the Staggers Act. I came back to the ICC as Legislative Counsel in 1981 and was involved in the annual oversight hearings on the effects of the Staggers Rail Act. In general, as you know, the Commission has consistently testified that the Staggers Act is working well. These were not always easy hearings, however, particularly on the Senate side where Commerce Committee members like Senator Long and Senator Ford usually had a few comments on the ICC and its performance. Things will certainly not be the same now that Senator Long has retired. I remember one hearing at which the witness, as is customary, started out by trying to give his name and the name of the Association he represented. At this point, he was interrupted by Senator Long who commented that it didn't matter who he was or whom he represented — just get on with the testimony, the Committee had a full schedule.

But one of the strangest experiences at a hearing during my tenure involved not Staggers oversight, but a hearing on coal-slurry pipelines. It happened that, on this day, the Chairman was scheduled to testify at two hearings. When the coal-slurry hearing fell behind schedule, we left to attend a Joint Economic Committee hearing on motor carrier matters. After completing that testimony, the Chairman and accompanying staff returned to the pipeline hearing. Most of the Committee had left by this time; the two Congressmen remaining had only one interest: water. The Chairman struggled valiantly to convince the Congressmen that this was not a matter within ICC jurisdiction. Nevertheless, the questioning continued. Becoming increasingly annoyed, one of the Congressmen finally said, "Well, you've got a big staff down there at the Commission. Put them to work and get back to me with answers on these questions about
state water rights." And that is how it happened that our office researched the constitutional question of whether it is possible for Congress to protect state water laws in light of the commerce clause — learning more than we ever wanted to know about water law in the process! (Although perhaps this information may yet prove useful — the area where we live just outside Santa Fe is presently involved in litigation with several nearby Indian pueblos over water rights).

What can be said about the Staggers Act? For the most part, it is clear that the Act has accomplished its intended purpose of removing unnecessary regulation, providing an opportunity for carriers to obtain adequate earnings, and to respond quickly to satisfy shippers' changing needs. All of you would agree, I'm sure, that activity under the contract rate provision has been particularly noteworthy. I think the number of contracts filed since passage of the Act stands today at over 50,000. There are still issues in the rail area. The Railroad Accounting Principles Board is presently looking at some of these questions. The RAPB released an Exposure Draft on February 20, 1987; its principles and report to Congress will be submitted later this year. The recent decision of the Third Circuit affirming the Commission's Final Guidelines in Ex Parte No. 347 (Sub-No. 1) should be helpful in resolving some long-standing controversies.

Other issues, including the future of the ICC, will undoubtedly be debated on the Hill as the year progresses. Dan O'Neil is going to focus on where we go from here. But it is important to note, I believe, that most of those who criticize Staggers have focused on the implementation of the Act by the Commission rather than the Act itself. The legislation was needed to assist in the revitalization of the rail system, and both carriers and shippers have benefited from the improved service (tailored to shippers' needs), more responsive pricing, and greater reliance on the marketplace which has resulted from the Staggers Act.

In closing, I would like to say — in case you're wondering about the absence of jokes in my presentation — well, since, as Chairman O'Neal will recall, I tend to forget jokes as well as punch lines, I have decided to leave this to our next speaker, Will Riss. We were on the Hill together and, as I recall it was always his task to come up with jokes or anecdotes appropriate for the occasion (though he did accuse those who used them of messing up the timing).

Again, I'm delighted to be here today. Thank you.

MR. O'NEAL: Thank you, Jan. I do remember some of those hearings. I remember we had a problem with the L. & N. Railroad in Kentucky, and we had a meeting down here at the Interstate Commerce Commission with both U.S. Senators from Kentucky, the Governor of Kentucky, Governor Carroll, at that time and Carl Perkins, who was one of the more
senior members of the House. They brought in local Kentucky television, and we had quite a show in what was the Commissioners’ Conference Room at that time. We had a lot of fun trying to close that meeting, I remember, because I thought that, since the meeting was at the ICC, I should be the one who closed the meeting and said, “Thank you very much; we’ll do what we can.” Every time I tried to close it, though, Carl Perkins would insist on having the last word. We went around for about ten minutes, and finally, I gave up. I figured, well, he’s the senior congressman up there, and I guess I better get smart and not go any further.

We had a hearing later. The Commission adopted a 27 percent increase for coal rates into that area, and Senator Wendell Ford, I think, unfortunately, he still remembers this. We had a hearing on the Hill shortly thereafter, and after everybody else had questioned me, and Jan, I think, was with me at that time, — Wendell Ford looked at me, and he said, “Now, Mr. Chairman, we’re going to play some hard ball.” And believe me, it was no fun.

Next I want to introduce Will Ris. Will was also on Capitol Hill. He was also with the Senate Commerce Committee, and he was there during a very critical period of time. From 1978 to 1981, he was majority counsel to the committee, and he was the primary staff person responsible for drafting the Motor Carrier legislation. He was once at the Civil Aeronautics Board. He worked not only on trucking legislation, but he also worked on airline deregulation. He is now a principal in the firm of Wexler, Reynolds, Harrison & Schule. They do Washington-type things like lobbying and government relations. They have a lot of different clients — American Air Lines, USAir and several others.

Will received a B.A. from Northwestern University, an M.A. from Johns Hopkins and a J.D. from the Denver College of Law and an L.L.M. from Georgetown. So Will, I guess, during the course of that has learned a lot about a lot of things, including good jokes. So, Will?
MR. RIS: Thank you. I appreciate that. Actually, I wasn’t planning on telling any jokes, but my memory was jogged, and I have to tell my favorite Congressional hearing story, if you don’t mind.

This was a Commerce Committee hearing on trucks; I’m not sure whether it was oversight or not, but I am sure there are some people in this room who were there. It was when Senator John Warner was a freshman on the committee. He had just recently been appointed to the committee. We had a witness who came from way, way out of town. He was not very well versed in Congressional etiquette, and he apparently didn’t know who the senators were, and he certainly didn’t know who John Warner was. But he did know that if he was asked a tough question, he had a stopper — a cute joke — that he would use in order to stall for some time.

As it worked out, Senator Warner had just gotten up and left the room, and this poor gentleman who was all there by himself without benefit of counsel, got a very tough question. He wanted to stall for time, so he used the little joke that he had come prepared with. He said, “Well, Senator,” — it was Senator Cannon who was asking the questions — “Senator, I’m sorry. I kind of feel like Elizabeth Taylor’s seventh husband. I know what I’m supposed to do, but I don’t know how to make it interesting.” Well, this is true. Absolutely true. I don’t know if any of you remember that day.

All I can say is, I’ve never seen so many senators fall to the floor so fast. The laughing must have gone on for three minutes. He must have
thought he was the best joke-teller that had ever been born. It was incredible!

Anyway, I will try to be as brief as possible, although I realize that time limits are very much like speed limits. You can go five, ten minutes over — no. I’m glad that Jan talked about rail issues, so that I won’t have to. It’s good news. It will cut down my remarks, and also I don’t know anything about them. So that’s very good news.

I would like to talk about 1980, that’s my assigned topic here. What happened? Why did it happen? And as you know, there’s a cliche in this town that making laws is very much like making sausage. It’s a process you don’t want to see up close, especially if you like either one of them. Whether it is appetizing or not, however, passing laws is an enormously complex process. There is actually an analogy that I think is less entertaining, but more apt. Passing a major controversial piece of legislation is like sending a rocket to the moon. And when I say that, what I am talking about is all of the things that have to work precisely together, to get a rocket through a very narrow window in space to get into the right orbit at the right time. So it is with major pieces of legislation. The only difference between rocketry and legislation is the rocketry is 99 percent science and 1 percent chance, and legislation is just the opposite.

My point is that the legislation of 1980 did not come out of the blue. It was the end product of a long series of events and actions that began more than two decades earlier, many of which had little or nothing to do with the ICC or surface transportation regulation itself.

In my very brief time, I want to try to highlight a few of these things. In so doing, I am really doing injustice to the subject, because it is far more complex than this. But in preparing these remarks, I realize actually as I look back on this that without me the whole process would never have taken place.

So I would like to begin with my own very considerable and essential role, but it is not what you think. Back in 1975, just fresh out of law school, I got my first job — real job — at the Civil Aeronautics Board. Now when I came to Washington to take this job, I didn’t know CAB from FAA, ICC, ITC, FTC — they all sounded alike. I didn’t know what I was going to do, and I quickly discovered when I got there that new attorneys at the CAB were broken in by being given only the most obscure and unimportant cases.

So there I was. I found myself contemplating whether to support Air Ecuador’s request for a charter flight to Toledo and other momentous requests, when all of a sudden one day, one of the cases given to me, a junior attorney, was a request for an exemption to use large aircraft by an obscure cargo operator named Smith, who had an airline called something like Express Something. Oh, yes — Federal Express.
This is a true story. I was told by my supervisors, this is a backburner issue. We’re not sure who this guy is. We think it’s a front for Flying Tigers. We know he can’t afford these planes. We’ve got to protect the shippers. We’ve got to protect this guy against his crazy proposal. Don’t worry about it. So it went to the back of the pile. And like a good bureaucrat, I waited, and I pondered, and I deliberated, and I studied. No one asked for the papers, except for an occasional plea by the guy’s attorney, and weeks turned into months, and months turned into years. Now if I had acted quickly and if the application had been approved, no telling what would have happened. I was willing to wait. The CAB was willing to wait. But Fred Smith and Federal Express were not willing to wait.

They went to Capitol Hill and they complained about the bureaucratic intransigence, and they were right. The other airlines didn’t seem to care much. They were getting out of air cargo at that time. It wasn’t that important to them, so that at the end of the 1977 congressional session, without much fanfare, Congress passed the Air Cargo Deregulation Act as a reaction to the intransigence of those faceless bureaucrats at the CAB.

That was the beginning of series of deregulation bills that would soon include passenger airlines and would move on to trucks and buses and trains and freight forwarders. It was a critical icebreaker. Without Fred Smith, who knows what would have happened?

The point of this is that I urge you not to underestimate the importance of the airline deregulation legislation as a precursor of what happened in 1980. It was very important. By the time 1980 came along, you have to remember that the House Public Works Committee and the Senate Commerce Committee had been through three hard years of deregulation debate and markups and action. It took countless hearings and 23 executive sessions for the Commerce Committee to mark up the Airline Deregulation bill, and so by the time truck legislation came along, there was no regulatory rhetoric on either side that the members of this committee had not heard ad nauseam. Small community service, small shippers, cutthroat competition, safety, and consumer protection. The players may have been different, but the rhetoric was the same.

Meanwhile the economy was playing a major role in the development of the legislation in 1980. Again, a matter of chance and a matter of fate. The fact was that the economy was doing well between 1978 and 1980. Airline travel had increased dramatically, profits and fares were up. And so looking at the airline industry, Congress came to the conclusion that deregulation worked. Had the economy been going down, it might have been different but it wasn’t. Another matter of fate and chance.

That fact made motor carrier and rail regulation or deregulation easier. The congressional committees were less gunshy. A new chairman
was appointed at the CAB, Fred Kahn. He became a media figure, an articulate spokesperson for deregulation. In addition, during the airline debate, key members of Congress became educated about regulatory issues and impassioned advocates of deregulation. Again, a key element for what would happen in 1980. In particular, Senators Kennedy, Packwood, Stevenson and Schmidt became ardent proponents of deregulation, and I would throw Senator Cannon into that category in a more low-keyed role.

On the House side, people like Representative Alan Erdahl played a key role, and played a similar function.

The airline legislation also brought together an extraordinary alliance of groups on the outside from the private sector, a coalition that remains together even today, with groups so diverse as Ralph Nader’s Congress Watch and the National Association of Manufacturers. Strange bedfellows having suddenly found themselves on the same side. It was and remains a unique potent force in the debate.

Now to some extent, the fight in Congress was a fight between the trucking industry and its customers, and as in most of those fights, the customer eventually is going to win, because the customer pays the bills. Part of the battle was driven by the pressure of technology and productivity, and again, something to take into account, events outside the Commission in the real world. What was going on was that corporate America was beginning to recognize that the transportation component of the goods it produced throughout the country was more important than it had ever realized.

As a huge continent competing with island nations, U.S.-produced goods require many more shipments from raw goods to finished products over much longer distances than imports with which they compete. So transportation is enormously important, and distribution managers were being asked both to reduce costs and find more rapid and reliable service. A regulatory system designed in 1935 simply wasn't able to meet that kind of a demand.

The issue of collective ratemaking brought another element to the debate — the academic community. It was anti-trust issues that that drew Senator Ted Kennedy into the debate as early as 1975. He had gone to his staff seeking an issue on which he could be both pro-free enterprise and pro-consumer. Deregulation was a natural. Working with only a thread of legitimate jurisdiction, one thing that John Kinnaird and I can agree upon, from his base in the Judiciary Committee, Senator Kennedy managed to prod the Commerce Committee and the Senate into action on both airlines and trucking. Had he turned his attention to a different issue, who knows what would have happened?

In 1976, another critical event occurred. A peanut farmer moved into
the White House. Now he may not have succeeded in many other areas, but on the issue of deregulation, he was unsurpassed. And I really think, and I didn’t mean that in a derogatory sense, I think being a peanut farmer was a real issue here. The man understood transportation. His business depended on transportation, and he also happened to know that you could move goods from one place to another on trucks that were not regulated, because his products were exempt. The the fact is, Jimmy Carter was personally committed to deregulation. His personal interest and enthusiasm was conveyed to the very top officials in the White House and DOT.

I remember Neil Goldschmidt, the Secretary of Transportation, telling that wonderful story about the first time he went in to talk to the President, after he had just been appointed. He had a list of 14 things he wanted to do as Transportation Secretary. President Carter, he says, took the list and penciled in at the top: (1) trucking deregulation; (2) railroad deregulation.

The personal involvement of President Carter was a very critical element. In probably his most important act, President Carter looked around this building to find the most wild-eyed, irresponsible, and uncontrollable member to elevate to the position of chairman. Naturally, he settled on our moderator today, A. Daniel O’Neal.

Dan O’Neal is the Jerry Rubin of deregulation. Eight years ago, he was thought to be the devil himself, and the industry is buying services from him. I think it’s wonderful.

Actually, looking back, Dan O’Neal looks about as radical and dangerous as Willard Scott.

Dan had the audacity to do two unthinkable things. One was to review seriously the Rate Bureau agreements. The other was to develop the concept of master certificates.

Now I don’t know many people on Capital Hill who had a good idea of what a master certificate was. In fact, I don’t even know if Dan had a good idea of what a master certificate was. Frankly, I forget. But one thing was sure, this madness had to end. Which brings us to the final piece of this broadly written puzzle, and one that sometimes we forget.

For the trucking industry, represented by ATA and the Teamsters, the number one priority for 1979, as far as I’m aware, and John can correct me, was legislation to stop Dan O’Neal. In other words, they wanted a bill. Once there was consensus among both the pro-regulation forces, namely, the truckers and the Teamsters and the pro-deregulation forces, namely everybody else, that legislation was desirable, the die was cast.

There was reference this morning to the October 1979 speech that Senator Cannon delivered to the Commissioners. It was a tough speech.
It was widely remembered for his statement about being mad as hell and not going to take it any more. But the real importance of that speech was that Senator Cannon announced that he and Chairman Biz Johnson of the House Public Works Committee had agreed they would pass legislation by June 1, 1980. That artificial, self-imposed deadline took on a life of its own. It was applauded by the trucking industry. It was quietly applauded by the shippers. It became almost magical. At that point, legislation seemed unstoppable.

What I think people in the industry did not know at the time was that Senator Cannon had already decided that the direction in which he wanted to go was towards deregulation. Later in 1980 — and I feel compelled to mention this, because it is a matter of the public record — when certain members of the Teamsters Union were indicted for attempting to bribe Senator Cannon, he became even more resolved to stay the course. He did not shift. He just became more resolved to stay the course.

Again, events and personalities meshed precisely during the consideration of the bill in the Senate. Three absolutely key provisions in the Senate Commerce Committee were passed by one vote each. Had just one voted changed, the legislation would have been vastly different.

Finally, let’s not forget that there were two houses of Congress involved here, my friend and colleague Jack Fryer is going to discuss his viewpoint from the House perspective. The House Public Works Committee was a very, very key player here. People tend to focus a lot on the Senate side. I think it is fair to say that the House Public Works Committee was more sympathetic to the views of the trucking industry than was then Senate. Nevertheless, this was the same committee that was a partner in passing airline deregulation and was a willing player here.

Last point. The final compromise was the last key to what’s happened in the past few years. To greatly simplify the debate, there were two main issues — entry and ratemaking. The Trucking Association felt that collective ratemaking was the number one thing they wanted to preserve. The Teamsters felt that entry controls were the number one thing they wanted to preserve. When the balance tipped, it was in favor of collective ratemaking, more of that was preserved than entry. I think the ATA won on the politics, but the Teamsters were right on the policy. Entry was more important.

Thank you very much.

MR. O’NEAL: Well, thank you, Will. That was really well done, and I really didn’t think it was that expensive either.

For your benefit, I thought I ought to recognize the fact that Senator John Warner just stepped into the room.
There is another point of view on what happened. We have with us John Kinnaird. I've known John for a long time. We used to have Chinese lunches together back in the '60s. He probably has thought a little bit about what we were eating at those lunches and wondered if maybe the food shouldn't have been changed somewhat, given what has happened subsequently.

John is what I consider to be a real Kentucky gentleman. He was a professional lobbyist, and I would say one of the best, if not the best that I have ever run into on Capitol Hill. He, like Jan, has gone off to someplace that I could not spell without being able to read it here and can't pronounce very well, but it is something called Rostau Plantation down in Pawley's Island, South Carolina.

John was a fighter pilot in World War II. He earned a law degree at the University of Kentucky. He practiced law in a small town in Kentucky for many years. He was involved in state and local government in the State of Kentucky. He practiced before regulatory commissions and before state and federal courts. He has been active in the National Association of Regulatory Utility Commissioners in many other areas. He was an officer with Consolidated Freightways. He was a partner in a law firm, Ray, Cross, Kubel & Kinnaird.

In 1967, he became special counsel to the president of the American Trucking Association and began a very fruitful career as a very successful lobbyist. He is retired now and lives down in South Carolina, as I said, on an old rice plantation on the Waccama River, and he's taken up some different activities. He's the president of the Waccama Muzzle Loading Rifle Association, and chairman of the board of the Pawley's Island Litchfield Rescue Squad. He didn't put it in here, but I found out he's also a member of the Sierra Club. Can you believe that? He's also a member of the — I think he said the League of Women Voters; is that right, John? One of the few male members of that organization, at least in South Carolina.

John Kinnaird.
MR. KINNAIRD: Thank you, Dan.

Thank you. It is really great to be back here in Washington, and it's nice to look out and see a few, shall we say, old friends out there in the audience.

I have a rather unique opportunity to follow Will Ris, and I agree with about 99 percent of what Will says, but, you know, like everything else in life, there are different interpretations. Frankly, for the past several years, with all due respect to the Interstate Commerce Commission and motor transportation, the last thing that's entered my mind has been this subject.

So, out of the clear blue sky, Fritz calls me and says, "Hey, John, would you come up to Washington and talk about the Motor Carrier Act of 1980?" I thought, Lord, has it been that long?

So, Fritz says, "I want you to paint a picture." And that always reminds me of the old story about the Sunday school teacher, who is going around the class and notes a little girl drawing a picture. The Sunday school teacher says, "What are you drawing?" The little girl says, "I'm drawing a picture of the Lord." The Sunday school teacher says, "Well, I don't know how you're going to do that, for we don't know what the Lord looks like." And the little girl says, "Well, when I get through, you will."

So hopefully, when I get through, you'll have Will's views on one side and mine on the other. And while I'm talking about such a difference of opinion, I want you to know that the views which I express here, the statements that I make, are mine and mine alone. They don't reflect those of the American Trucking Association or any other groups or my staff or any other person. I'm just going to tell you the way it was as I saw it. I agree
with Will about the rockets and legislation. I do think it’s 99 percent chance and 1 percent skill. I think that if it hadn’t been for people like Will and Jack Fryer and other, we wouldn’t have the law today.

To really get this subject in focus and move along, most of you should know that, at that time, the American Trucking Association was an umbrella organization. It had a strong grass roots organization in each state with a very politically able state trucking association. Frankly, we felt that we could take care of ourselves politically. But the problem we faced was one created by my old friend, A. Daniel O’Neal and his “radical” thinking of the late ‘70s vis-a-vis deregulation of the trucking industry. When you are on the banks of the Wacaseamaw River in South Carolina, everything seems to come into a better focus. You look at the nation’s capital and realize that it attracts people who want to change things.

If you think about it, that is all we seem to get in Washington, people who want to change everything.

So I think Dan and his followers came to office and they wanted to make changes. Unfortunately, we get a lot of people who want to change purely for the sake of change. That creates problems. But I am not here to sound forth on philosophical matters. Let’s just say that at the time this legislation got started, ATA was very concerned at ICC deregulating by what we called administrative fiat.

In 1986, on the Saturday before Easter Sunday, I received a phone call asking me to be at the Airport Hilton in Atlanta, Georgia at 8:00 o’clock in the morning on the Monday following Easter Sunday. Well, getting out of Washington on Easter Sunday was a pretty rough job, but I managed to do it. Got down there late that night, checked into the hotel. The next morning I, along with a group of Georgia truckers, met with then presidential candidate Jimmy Carter. He was accompanied by Stu Eizenstat. When the meeting started, Mr. Carter wanted to know what he could do to win the support of the motor carrier industry. He said he had told Stu about it, and Stu had suggested the meeting. So I asked Stu if he was familiar with what the Commission was trying to do in Washington relative to truck deregulation. Stu said, yes — that he had practiced two or three cases before the ICC and knew all about the deregulation issue. He assured us that if we supported Mr. Carter for president, the last thing in the world we had to worry about was deregulation.

I know I’m not sworn, but I’m telling you the truth. I was there. About that time, Mr. Carter, who hadn’t been saying a whole lot, got up, and said, “Now, I’m very familiar with you fellows and your business. You have to have a permit. I, too, have to have a permit in my business of raising peanuts. So I know all about this general subject.” He then said, “I’m not going to do anything to adversely affect my peanuts, and you can rest assured that if I’m elected president, the last thing in the world the
motor carrier industry will have to worry about is losing its operating au-
thority or whatever Stu Eizenstat's talking about.'

So the truckers all came out of the meeting starry-eyed. They asked
me what I thought, and I said, "Well, I've been around politics most of my
adult life, and I just take all this under advisement." Then ATA has its
annual convention.

Burt Lance showed up. He was Mr. Carter's right-hand man at that
time. He met with our leadership and with my staff. He again assured us
that, if we would support Mr. Carter instead of Mr. Ford, we had abso-
lutely nothing to worry about.

So most of the motor carriers supported Mr. Carter, in spite of the
fact that Mr. Ford had been our friend for many, many years.

And we'll let that story rest right there.

Now we all know that things change, whether change is warranted or
not. We all know that political commitments and promises and things of
that nature are often subjects of tremendous misunderstanding, and par-
ticularly after the fact — I guess one should say after the election. So I
wasn't really surprised. I was somewhat disappointed that a man of that
character, having been governor of the Great State of Georgia, reneged
on his pre-election statements. The deregulation drums continued to beat
and the Carter Administration continued to march to that beat.

The posture of the trucking industry at this time was one that politi-
cally we felt could handle the situation. We were concerned about Dan
and the ICC. Then started the legislative process. Now, I don't want to
bore you, so I won't go into all the details. Senator Kennedy got into the
act, asserted his jurisdiction, and Senator Cannon became concerned.
We worked with Senator Cannon, shot down Senator Kennedy, and then
we got Senator Danny Inouye to introduce bills for ATA. Next, the Team-
sters got into the act and had their bill introduced. As I recall, ATA had
bills introduced in the House as well as the Senate.

Then somewhere along came the facts that Will referred to — Chair-
man Cannon assured the President that he would have a bill by June of
1980, and then told the ICC to cease and desist on all of that questionable
deregulation activity that was being done.

Somewhere, Senator Packwood entered the scene, and if my mem-
ory is not too good, I hope, in light of the recent lapse of memory in the
Great Nation's Capital — I will be forgiven!

Now I differ a little bit with Will about Senator Cannon's attitude along
about this period, because he had made some speeches that we thought
were rather promising, particularly with respect to rate deregulation. In
fact, with his permission, we had quotes from his speeches in our PR
program. Well, then the phone rang one night, and it was the ATA presi-
dent, Bennet Whitlock. He said, "John, I think the ballgame just went down the tube." And I said, "What do you mean, Bennet?" And then he told me about that situation which developed when a group of our "friends," those people that inhabit that great marble edifice up on the Senate side of Capitol Hill, the Teamsters Union got into the act. He told me what the newspapers had to say about the Teamsters and the alleged illegal activities vis-a-vis Chairman Cannon.

Frankly, we knew right then that enacting proper legislation was going to be very difficult. We felt that Senator Cannon was going to be locked into a pretty tight position on the other side.

Now other people have stated such was not the case. As I said at the beginning of my talk, the thoughts I express are my own. Thus, I do want to say that Senator Cannon, throughout this whole legislative exercise, was as fair as he could be, but the Teamsters' activity did muddy the water. Suffice it to say that Senator Cannon was no Fritz Hollings. I think we will all agree on that.

The legislation started on the Senate side, and ultimately we went to markup before the Senate Commerce Committee. ATA had a number of very able state association managers and truck operators who had been taling and twisting arms of all the members of the Senate Commerce Committee. We had counted our votes, and we felt pretty good. Well, the markup started, and it went very well at first, and then we started losing. We didn't lose by a whole lot, but we lost like 9 to 8, and then we'd lose by about two votes.

Well, I am in the back end of the room where the committee was meeting, and I am trying to, as "legally" as possible, signal to various members of the Senate how they should vote. You know, it looks rather bad, if you are standing there and openly saying, "Don't do that."

But communication wasn't at its greatest, to say the least. We came out of markup in not very good shape. We talked to some of those senators who had not followed the commitments that we thought we had. And again, we got into this old rat race that if they say that the lapse of presidential memory here a few months ago is anything new, I got news for the press. It's been going on for a long, long time!

You know, I've spent all my adult life either practicing law or practicing politics, and I have heard all these songs before. I just didn't think it would be played at that time and perhaps I was naive. Will and his group had the votes, and we just didn't know it.

So, we came out of that Senate Commerce Committee markup wounded, to say the least. We met. We had a committee called the Strong Committee, and it represented all phases of for-hire and private regulated and unregulated motor carriage. The Committee decided there
was not going to be a bill. We were going to kill the bill and let the ICC
possibly destroy the industry while we took our chances with the courts.
We hoped that time would permit us to get to court and convince the court
of our position before we were terminated by the ICC.

About that time, I got a phone call — I don’t remember whether it was
Will or who on the Senate staff. They called and said they would like to
have lunch, and we went to lunch. And they said, “We want a bill.” They
thought we could work out an accord. We agreed to go back to our peo-
ple and talk to them. Will, in his remarks, was talking about how legisla-
tion is enacted. This will prove his point. Our people decided that they,
too, would rather have a bill hopefully to put an end to all this deregulation
effort. We then went to the House side and talked to Biz Johnson, who
was then Chairman of the House Public Works Committee, to Jim How-
ard, who then was Chairman of the Subcommittee, to Jack Fryer, and
others. What we were trying to do — and I think we all did it — we were
trying to sell a package. I think Jack is going to talk about, and I certainly
won’t go into that.

You ought to bear in mind that 1980 was an election year. Election
year makes a big difference politically. ATA felt that, in spite of what Will
says about airline deregulation, a numbers of members of Congress
were having second thoughts about having voted to deregulate the air-
lines. Frankly, ATA could have killed any regulatory reform legislation. In
fact, when the bill came out of the House committee, we had to work very
hard to get enough votes for it to pass.

One or two other things. There was one group of shippers which
supported us. There were numerous groups of shippers which opposed
us. When you are in the trade association business, you’ve got to always
have an issue to sell to your membership. So there were a number of
trade associations on the Hill that didn’t have a great deal of activity.
When this issue of possible deregulation of the trucking industry arose, it
seemed that every Tom, Dick and Harry was against us. I felt like those
fellows at the Alamo, to tell you the truth.

But anyway, we were able to get the bill enacted into law.

Now, as I said earlier, the thoughts that I have attempted to express
here are my own. Several of the members of the panel wrote the exact
language of the bill, and they witnessed its passage, and they may or may
not agree with my version of the events. As a former practicing attorney, I
learned a long time ago that whenever two people see the same events,
they can always differ as to what took place, so I beg the indulgence of
the members of the panel, if, in their opinion, I have erred. Throughout all
of this, we in the motor carrier industry were assured by the Carter Admin-
istration that, once the intent of Congress was established by this bill, the
Carter Administration would see to it that the ICC would follow the intent of Congress as set forth in the Motor Carrier Act of 1980.

Now as to whether or not that transpired, I will leave that up to your good judgment.

It's been nice being here. Thank you.

MR. O'NEAL: Well, John, that was a very interesting perspective, and I think you lived up to your reputation as being a person who can disagree without being disagreeable. You gave us a really good idea of how it looked from your side.

The next and last speaker is the only one of the group who is still working on Capitol Hill. He went to Capitol Hill from the Interstate Commerce Commission back in 1975. He had been at the ICC before that for about 12 years. That is when I first met Jack. He was, I guess, one of the first of a whole series of people who went from the Commission up to the Hill and worked on the staff on both sides and who played a major role, as he did, in much of the deregulation legislation that was passed in 1980.

Jack is the — his title is Counsel to the Surface Transportation — let's see, Counsel, Surface Transportation and Regulation. He is on the staff of the House Public Works Committee. The title, you know, really doesn't mean that much. Jack is the key person on the House side, if you want to talk about the regulation of motor carriers and a few other things that he does there.

Jack graduated from the Georgetown University Law School.

I am very pleased to introduce Jack Fryer.
MR. FRYER: Thank you, Dan. I want to thank the Planning Committee for asking me to participate in this panel discussion.

As one of the alumni of the Interstate Commerce Commission, I consider it a great honor to be here, and I guess I have to say that about Capitol Hill also. You will note that all the panelists, after the Motor Carrier Act and the Staggers Act were passed, either left town or went downtown.

And they left me on Capitol Hill to listen to the endless oversight hearings.

The topic for the panel, “Congress and the ICC — The ‘80s Legislation,” which, for the most part, was reform legislation, is being discussed immediately prior to a discussion on “Transportation without Regulation.” It is provocative positioning of topics, one which would have been exactly in reverse a century ago.

In the 1980s, Congress essentially deregulated the airline and surface freight forwarding industries and provided for major reforms in the rail, truck and bus industries. The reduced responsibilities of the ICC also resulted in legislation which reduced the number of commissioners at the Interstate Commerce Commission from 11 to 5.

The ‘80s legislation, that I was personally involved with and which relates to today’s program, is the Motor Carrier Act of 1980, the Household Goods Transportation Act of 1980, the Bus Regulatory Reform Act of 1982, the Coal Slurry Transportation Act, twice, the Surface Freight Forwarder Deregulation Act of 1986 and the bill to reduce the number of commissioners at the ICC from 11 to 5.
All of this legislation has been enacted Coal Slurry. Moreover, all of this legislation was agreed to by both houses of Congress, either without a conference or with a pro forma conference without a meeting of the conferees, except one. The bill to reduce the number of commissioners at the Interstate Commerce Commission from 11 to 5 required a conference and at least one or two stormy meetings of the conferees.

From a personal perspective, each reform act was easier. The Motor Carrier Act of 1980 was the most difficult to get approved. From the stormy beginnings of reform initiated by the Commission to the final floor debate in the House, debate was contentious.

In the spring of 1980 and after the Senate had passed its bill, all of the interested parties, which were many, agreed to legislation that provided for major reform. The reform theme was, less regulation and more competition, not deregulation.

The reform bill was known as a delicate balance act, and for good reason. Once agreed upon, all or rather most of the parties agreed to support the legislation, provided the Committee on Public Works could clear the bill at committee level and on the floor of the House of Representatives without amendment, not agreed to by all of the interested parties. The bill moved through committee, and the committee was able to maintain the agreement. The subsequent floor fight was long and hard-fought. There were approximately ten amendments, three of which required roll call votes.

The closest vote and the one which clearly would have destroyed the delicate balance was the vote on the one-house veto. The committee was able to defeat the amendment by a three vote margin.

It was the first time the veto amendment had been defeated by the House of Representatives. The delicate balance was retained. The House overwhelmingly approved the bill; the Senate accepted it; and the rest is history.

After that, the Household Goods Act and the Bus Regulatory Reform Act were easy to do. And last year, The Surface Freight Forwarding De-regulation Act was a snap.

The Household Goods Bill and the Freight Forwarder bills passed on unanimous consent, with the latter taking about 10 minutes to pass the House.

Plainly, the initiatives of the first seven years of the 1980's reflect a Congressional attitude of “less regulation is best”. So it seems that from 1887 to 1987 we have traveled down a policy highway that appears to be headed in a full circle.

However, the Congress has not yet decided to go the last mile and close that circle. Moreover, there seems to be very little sentiment for
deregulating the railroads and, certainly, there does not seem to be an overwhelming wish to go the last mile in the areas of truck and bus deregulation.

I worked for a committee that easily cut the regulatory bond with airlines and freight forwarders. It acted upon major reforms for the truck and bus industry, and worked hard, but in vain, to facilitate more competition in the transportation of coal.

The Coal Slurry legislation was defeated by a formidable coalition, some who advocate competition in the transportation marketplace, but apparently only sometimes.

Now the committee has before it a proposal which would essentially close the book on motor carrier regulation, close down the ICC in its 101st year, and transfer the authority to regulate railroads and what remains of motor carrier regulation, which would be little, to other government agencies.

I cannot say for certain whether the proposal will eventually fall within the historical context of legislation of the 1980’s, but I can tell you with reasonable certainty that motor carrier regulation will not end in 1987.

The proponents of that legislation have formed a coalition, which is the same strategy that led to enactment of the Motor Carrier Act of 1980. There is a difference now. In 1980, almost everyone supported reform, but very few advocated total deregulation when given that choice.

After seven years of reform, there are some who apparently now believe that the time has come to deregulate and they have begun their efforts to swing the Congress to their position.

Having sat through lengthy oversight hearings on the Reform Acts of the eighties, the position of the coalition is neither new nor surprising to me, nor to the members of Congress.

Thus far, there has been a reluctance to act on the part of the Congress, but before I have seen reluctance convert to advocacy and that may happen again.

Before that occurs, I would guess that the steadily increasing loud drum beat of safety that has suffered under reform, must be heeded.

Everyone on this panel who worked on regulatory reform, and we all did, knew it was a sound we would hear. We have not been disappointed.

Since economic reform was initiated, Congress has enacted comprehensive safety laws to address truck and bus safety. The safety reforms were not made simply because regulatory reform meant more trucks and buses on the highways, they were made because they, too, were needed to address the concerns that resulted from a grown-up truck and bus industry.
However, by coincidence or by cause, since regulatory reform, the safety record is not good. I don't believe the result can be explained simply by saying there are more trucks and buses on the highways, and the number of truck and bus miles has increased. The American public, in my view, will not buy that.

Nor, do I believe, will the Congress. In support of that view, I refer you to your newspapers on a daily basis and to your television sets, where there is increasing concern expressed about motor carrier safety.

There certainly is no clear, satisfactory explanation as to whether reform is the culprit. If there is a nexus, it needs to be known. In that respect, the committee has asked the Office of Technology Assessment to examine the question and to furnish the committee with the report.

Hopefully, that report will shed some light on the question and help lay the foundation for appropriate congressional action.

If there is a connection, it does not necessarily toll the death knell for deregulation. It may simply mean more and tougher safety laws.

Based upon safety questions and a lack of clear interest to deregulate on the part of the Congress, I think it's very unlikely that the 1980's will see the end of regulation in the trucking industry.

With respect to the bus industry, my view is that unless some way is found to deregulate that industry and, at the same time, preserve the state preemption aspects of the Bus Act, deregulation will not happen.

Our moderator, Dan, asked that I address some specific questions relating to regulation and the ICC.

The questions fall into the category of congressional attitudes towards the ICC and regulation, present and future.

My first question is: What is the current attitude of the Congress towards the Interstate Commerce Commission?

The only sure way to discuss a congressional attitude towards the ICC is to poll the members and take a vote, which, for obvious reasons, is an option I chose not to pursue.

However, there seems to be no overwhelming groundswell to sunset the agency. I think we can say that the Congress collectively tolerates it, and probably wants to keep it, at least for the time-being.

My second question is: Does the arm of Congress still exist?

My answer to that is: You bet it does. However, it also seems like the arm sometimes is not long enough to reach from Capitol Hill to 12th and Constitution Avenue.

The Commission's function is to regulate commerce, which is the constitutional function of the legislature. In the 50th annual report of the Interstate Commerce Commission, the following quote appeared — and notice the first two words:
"In theory, the Commission is an arm of the Congress and exercises specific powers vested in it by law to regulate interstate transportation of persons and property.

Essentially, the mission the Commission was created to carry out in detail, the general standards or rules of conduct with regard to transportation prescribed by the legislative branch of government under its constitutional power to regulate interstate commerce."

Later in the same report, the Commission says:

"The Commission is often referred to as an independent governmental agency, but in the strict meaning of the word, it is not independent. It has no power to initiate nor to determine new policies of government.

It is, in fact, an integral part of the governmental mechanism directed by a statute to perform only special duties."

Forty-three years later, when the Motor Carrier Act of 1980 was enacted, that act contained the following language: "The Interstate Commerce Commission should be given explicit direction for regulation of the motor carrier industry in well-defined parameters within which it may act pursuant to congressional policy."

The statement echoed the remarks of Senator Howard Cannon, who, in his famous speech on October 22, 1979, said:

"We also expect the ICC to act within the statutory framework and respect the intent of Congress. The Congress does not expect any independent agencies to act in novel ways to achieve their own special goals; nor do we expect agencies to act in areas where we have clearly indicated Congress will address in the near future.

It is not the responsibility of the regulatory agencies to determine how the American economy should operate on a day to day basis. Such broad policy decisions will be for the Congress to decide and the agencies to implement.

If there is no misunderstanding as to our roles, I am confident that our partnership can be an effective one."

In my view, nothing has happened in the last 50 years — or in the last seven — to change that theory. However, there’s a huge word in the act, or in the implementation of the act, which is "discretion".

Any agency, in attempting to administer a law exercises discretion. How that is exercised sometimes causes genuine disagreement.

The next question is: What sentiment is there on the Hill for making the Centennial the last birthday of the ICC?

Again, this is a very difficult question to answer. The current mood that I perceive is to retain the status quo. However, the Congress is not showing any strong attitudes either way. And I think that if a strong case can be made for less regulation or deregulation, the Congress will do it.

However, I must stress that I don’t see that happening by the ICC’s 101st nor by its 103rd birthday.
Another question: Is there a different attitude towards the agency than there is towards deregulation as such?

In a word, yes.

My final question is: Has the pendulum swung back in the direction of more regulation?

Definitely not. The pendulum has not swung back. And I strongly doubt that any swing of this type will occur in the near future. Prior generations opted to regulate for a variety of reasons. Strict regulation became costly and inefficient. The moves by a new generation with different attitudes forced to change the scope of regulation, which attitudes I believe still prevail.

In my opinion, the chances for deregulation or less regulation are far more optimistic than the chances of reregulation.

As Congressional staffer, I was fortunate in having a ringside seat at the reform debate of the 1980's. It was exciting to me, and sometimes a little too exciting, during which competing advocates advanced their best ideas as to how a free economic system should work at its gut level, transportation.

After debate, the clear Congressional choice was reform and retention of the ICC in a limited manner. My guess is that the 1980s will not see a change in that choice.

In one respect, I sincerely hope my prediction is true. I say this because I'm somewhat fatalistic in my approach to events. There is some foundation for my concern, which is tied to the ICC, its age and regulatory policies.

Euphemistically, in my career I've been twice hit by a train while working on coal slurry legislation.

My real life experience has been more tied to motor carrier regulation. When the ICC was celebrating its 50th birthday, I was almost three years old. In my first attempt at childhood regulatory freedom, I fled the safety of my parents' backyard and was promptly hit by a truck as I crossed the street.

In 1962, the ICC was enjoying its 75th anniversary, and I was deciding on whether or not I should accept a job offered by Sheldon Silverman at the Interstate Commerce Commission. I was driving south on Route 22 and I was again struck by a truck.

In 1978, we were beginning work on legislation dealing with the regulatory controls of the ICC and I must confess, at that time, personally leaning towards less or no regulation, I was again hit by a truck — this time in a very serious collision.

Ladies and gentlemen, there are times when I have justifiably been accused of being dense, but I am not foolish. I finally got the message.
The message is simple. It’s happy 100th Anniversary, ICC, and many happy returns of the day.

Thank you.

MR. O’NEAL: Well, thank you. Jack is our last panelist. We had talked earlier about having interchange among the group, because we thought there might be some differences of opinion. But we are flat out of time.

And John Cleary is not going to allow me to engage in any more of this, so I want to thank all of the panelists, Jan and Will and John and Jack. And...yes, Will wants me to announce that if anybody wants a ride home, Jack will give them a ride. No problem.

If somebody will look at the rearview mirror for him, that’s... All right. Thank you very much. We’ve enjoyed ourselves. I hope you’ve enjoyed this presentation.

Mr. CLEARY: As we’re kind of shifting here, we’re going to keep moving along. But Fritz has just asked me to remind all of you that — I don’t want to encourage you to leave the room now, but on the way home after the session this afternoon, you might want to make sure you stop by the hearing rooms. Hearing Room A for the display of the memorabilia from the ICC; and then Hearing Room B for coffee and punch, cookies to fortify yourself between this session and this evening, when I hope many of us will be there for dinner.

I think we are just about ready to begin, now that we have our audio visuals in place. As you’re coming to your seats, I will repeat a little line that I heard last night from George Will, who is usually informative while being witty.

He was talking about deficit problems, etc. . . . And the concept of the economics that are interesting in this town and that are accepted in this town. And it drew him to quote Cardinal Wosley, who was advising someone who was going to go in with an idea to Henry VIII.

And Cardinal Wosley, being very wise, said: “‘Be very careful about what you put in his head, because it’s sometimes very hard to get out.’”

And I don’t if that’s where we are in the area of deregulation, but I think this last panel was very stimulating and I particularly found of interest and amusement the sort of inside talk that John Kinard gave us. And that’s what we’re hoping for in this day of reminiscence and thoughts on the anniversary of the Interstate Commerce Commission.

It’s particularly again a pleasure to be able to introduce the moderator for the next panel, who will then introduce the individual members. I think you can see this is an outstanding pair that we have this afternoon of panel members. We are truly honored again to have another former Commissioner, Commissioner Marcus Alexis, who is presently serving as
the Dean of the College of Business Administration of the University of Illinois at Chicago.

He received his bachelor of arts from Brooklyn College of Arts; a Ph.D. from the University of Minnesota, and has been an instructor and then professor at various colleges and universities, including the University of Minnesota, McAllister College, DePaul, the University of Rochester, Northwestern and a lecturer at the University of California at Berkeley.

Commissioner Alexis was appointed to the Interstate Commerce Commission in 1979, where he served as a Commissioner, Vice-Chairman, and acting Chairman.

So it is a pleasure that I can introduce to you the moderator for our fourth panel today, Commissioner Marcus Alexis.
MR. ALEXIS: Good afternoon. I am delighted that so many of you are willing to stay for this final session. I was afraid that we would have a little seminar between ourselves.

It's a pleasure for me to be back, in this my first official act of any sort since leaving the Commission six years ago.

Some of the points I have prepared have been covered in comments by the moderators of other sessions. But, since they are the only comments I have prepared, you will have to suffer through them once again.

I really mean these from my heart.

This morning, Mr. Miller spoke about service on the Commission. Over the years, I have given a great deal of thought to the two years I spent on the Interstate Commerce Commission.

I felt then, and still feel so today, that it was a great honor to have served on this Commission. It is the oldest of the federal regulatory commissions and has had a grand and glorious history.

It has served the people of this nation well in many respects. In the two years that I served on the Commission, we made historic moves towards putting surface regulation in a market setting. I will always treasure my service here as one of the high points of my personal and professional career.

I learned, because I occupied every office in the Commission, the importance of collegiality in the workings of the Commission. The ICC is a collegial body which works best when there is a consensus that can be clearly communicated to the public as the sense of the Commission.
It is important in developing that consensus that members respect each other even when there are differences in the positions that are taken. Mutual respect is an important part of developing consensus and collegiality.

I would be remiss if I did not say how important it is to have good staff. Some note has been taken of them today. It cannot be denied that the heart and the soul of this agency is its able and dedicated staff.

A popular sport is to make light of the "bureaucrats" in public service, the professional civil servants, to decry how little they work and how well they are paid.

I am one who does not share that opinion at all. Most of the staff at this agency that I have had the privilege to work with have earned their pay and more; many have stayed here when there were better-paying jobs elsewhere.

For the record, I would like to express my appreciation to those of you on the staff who made those of us in the comfortable commissioner suites look good. If it makes you feel any better, I never got to use my shower.

And I never opened that safe.

Those were two temptations I was able to resist.

Finally, I would like to say some things about the environment which existed in a policymaking sense during my tenure on the Commission and about the position that I and others who supported a movement towards a more market-sensitive rail and motor vehicle industry endorsed.

One, it should be said that it was always clear to those of us who supported regulatory reform — a term I prefer to "deregulation" — that motor vehicle safety enforcement was a very important element of reform.

Many people support the view, myself included, that enforcement could be better done by the Bureau of Motor Carrier Safety at the Department of Transportation.

The reason why safety is an important element in this reformed environment, is because it transcends the transaction between shipper, receiver, and carrier. Even if one is prepared to permit truck drivers to take risks that result in their death and the destruction of the goods they haul, one must still be concerned about others potentially (or actually) damaged by lax operators.

Safety is important because of what economists call externalities: costs (benefits) that befall persons not party to a transaction.

A second element which is important, is a vigorous enforcement of antitrust regulation, to guard against re-emergence of cartel arrangements, and the possibility of monopoly.

A third element is a severe penalty for genuinely anti-competitive be-
behavior, the type that harms the shipping public by restricting service and rate options.

These three elements were always preconditions to a general support for reform or deregulation, if you will, in the trucking industry and greater regulatory freedom in railroads.

One of the difficulties in regulatory reform is that people tend to remember the reform aspects and not the caveats. As I stand here today on this 100th anniversary of the Commission, I reaffirm my commitment to reform in the surface transportation industry.

Let me say, that I remain a dedicated supporter of the efforts that took place in the late 1970’s and early 1980’s which moved the trucking and railroad industries much closer to being market-sensitive and responsive industries.

The benefits of reform have been enormous. They have come about in ratemaking and in services. There have also been impressive gains in efficiency. We have seen innovative services that no one on the Commission could have imagined would develop so soon after implementation of the reform legislation.

The Commission can take some credit for its activities in the areas of developing and pushing the legality of contracts, and for its insistence that the Chicago and Northwestern have a property right in the rail link that was built in the Powder River Basin. The latter has resulted in a tremendous increase in competitiveness in the movement of coal out of the Powder River Basin.

I could name a number of others; Commission efforts have resulted in a very large increase in the number of minorities who now have certificates in the motor carrier industry. I understand that we also have minorities who own and operate railroad properties.

These are economic and social changes which I consider to have been momentous. There are still problems and things that we could not have anticipated. But I would think that on the report card of the movement towards a market operating system, that the changes that took place in the late seventies and 1980s would have to earn at least an “A-minus”. Now, I’m a tough grader, but I give a tough grade because, in this case, I am grading myself to some extent. I think a more objective and permissive grader would give the Commission an “A”.

Finally, let me say — and I hope I’m not stealing the thunder from our two speakers — on the future of the Commission: I am not at all convinced that moving the remaining functions of the ICC to other agencies would improve the manner in which those functions are performed. In particular, I think moving them to the Executive Branch would politicize
them to an extent that is not even thought of in the ICC. I am not even sure that they would be performed at a higher level of skill.

It seems to me that the real issue is: what functions should the ICC be performing? Or, what functions should be performed in terms of supervision or regulation of surface transportation?

Those that are not necessary should be eliminated altogether and should not be transferred to another agency.

And I would say that there is room — considerable room — for reducing the regulatory impact of the ICC. But the gains one would get by symbolically closing the ICC are outweighed by the potential damage of politicizing the regulation of surface transportation.

Thank you.

I've just decided on the order in which we'll go.

We have two distinguished transportation experts today who have written widely on the subject and are on different sides of the issue, as you might suspect.

Fortunately, they're not both economists because, according to the old story: if you placed economists end-to-end, you would never come to a conclusion.

I don't know what happens if you combine an economist and a political scientist, but we shall find out soon.

Our first speaker will be Dr. Frederick Thayer, of the University of Pittsburgh.

Dr. Thayer received his bachelor of Science degree from the United States Military Academy at West Point. He received a master's degree from Ohio State University in Political Science, and a Ph.D. from the University of Denver in International Relations.

Our second speaker is Dr. Thomas Gale Moore, who is a member of the President's Council of Economic Advisors.

Dr. Moore was educated not far from here at George Washington University, and received his Ph.D. in Economics from the University of Chicago.

He has taught at Michigan State University and was most recently Director of the Domestic Policy Section at the Hoover Institution at Stanford University, where I used to send a lot of money when my children were in school there.

I hope some of it went to you, Tom. I —

DR. MOORE: Not a cent.

MR. ALEXIS: Not a cent. Well, sorry to hear that.

Tom and I have spent a good deal of time at many conferences, discussing transportation issues. You will discover that those of us who sup-
port more market freedoms are not unanimous on how that should transpire.

Finally, I'd like to make one personal note. When OMB Director James Miller spoke this morning and recounted the involvement of those who were here, I must say that his account of history was not complete.

I am happy that our moderator did point out that, in 1981, I did serve as acting Chairman of this Commission and did play some role in the events that took place towards the movement for more regulatory freedom.

With that personal note inserted, I will now turn to Dr. Fred Thayer of the University of Pittsburgh.
THE TRANSPORTATION INDUSTRY AND EXCESSIVE COMPETITION

DR. FREDERICK C. THAYER

DR. THAYER: I don’t have any jokes, because I don’t regard this as funny. What you are about to hear is I hope nonpartisan and nonideological. I don’t have any more love for the state of political science than of economics. And I don’t have any association with any of the groups that are usually involved. I wrote one paper for a trucking association one time in which I told them that their own policy stance toward regulation was crazy and they should change it.

What I usually do in presenting my own ideas, economists call them insane, as in the recent book I did on making a case for regulation, so I’m going to rely a lot upon the words of others to argue a different point of view concerning the past, the present and the future.

I’m going to begin with an economic historian’s reprise of the Great Depression of the 1890’s and what had caused it.

Many industries, and particularly the railroads, had expanded their activities far beyond market demand. During the 1880’s, almost 74,000 miles of railroad were built, more than during any previous decade.

Much of this expansion was dictated not by any reasonable estimate of traffic, but by the pressure of competition. Each road recklessly and hastily threw up lines that were not needed through miles and miles of uninhabited wilderness, merely to ensure that another road would not claim the territory first.

Inevitably, enterprises built on dream and credit collapsed; when the dreams failed to materialize, credit evaporated.

The fortunes of other industries like steel were bound up with those of the railroads, and when the railroads began to fall in the summer of 1893, the
failure spread to other sections of the economy with 32 steel corporations failing in six months in 1893.

Economic activity had become interdependent in the weakness of the heart of the system and feebled the rest. The same conditions characterized banking. Formerly, failures in one part of the country had not necessarily caused failures in other parts.

By 1890, banking had become centralized in New York, where a large proportion of the reserve capital inexorably gravitated. These reserves had been freely used in speculation.

[The question is why?]

When stocks fell, city banks fell and, since the city banks held up the 60 percent of the reserves of other banks through the country, the panic, once it had seized New York, almost immediately became nation-wide.

Now, if you begin with the assumption which was widely held then that the problem was excessive competition, then you understand that what you are dealing with is what we know, of course, as the problem of the captive shipper, where on the competitive routes you have price wars, otherwise you have monopoly pricing because of captive shippers.

Now, the point of this is that when you regulate industry because of excessive competition, and you then use a grandfather clause to license all existing firms, you are merely perpetuating excessive competition.

Restriction or regulation of entry without regulation of capacity, or what we might call trip frequency on city pairs or traffic lanes, that kind of regulation merely perpetuates and encourages excessive competition. Merely regulating the entry of firms is not regulation.

Therefore, with an occasional and temporary exception, as in the early seventies with respect to the airlines, the transportation industries have never really been regulated in the conventional sense of the term. They have not been regulated in any real way. It is small wonder then that the ICC and the CAB did not do a terribly effective job of regulating those industries.

I am not, therefore, of the previous status quo with respect to these regulatory agencies. In my view, the transportation industries have always been under-regulated. They have been partly regulated only after the failure of free markets in each and every case.

Now that means that the behavior of supposedly regulated firms, which was in fact inefficient because we were perpetuating excessive competition, was the behavior of competitive firms, not monopoly firms.

The perpetual problem of the transportation industries across-the-board has been excessive capacity from day one. It has never changed. It is simply a little worse now. When you’re talking about failures and bankruptcies, et cetera, they are connected with the cause of depression, not the effect.
With respect to the great crash of the 1930's, for example, it is not
correct, as OMB Director Miller said this morning, that the idea of regula-
tion was a New Deal idea. It was not. Hoover and Roosevelt agreed as to
the cause of the Great Depression. Both labeled it: destructive and ex-
cessive competition. And the initial programs of the New Deal, which
were not supported by any school of economics, including the Keyne-
sians, were almost identical with what Hoover had proposed himself in
1931.

There was a difference, yes. But the problem here is that we are
dealing with a situation where, at the time, many non-economists and
many politicians agreed that the problem that they were looking at in the
1930's was really understandable as too much competition.

*The New York Times* praised the bituminous coal industry in 1931 for
suggesting a form of economic regulation, noting that all the agencies that
had examined the industry had blamed unregulated competition for its
problems. There were many bills introduced in Congress to authorize
curtailment of production. And railroad executives routinely met to try and
reduce preventable and competitive waste. Even professors at Harvard,
at a time when economics occasionally studied how industries actually
operated, noted that competition must be restrained with respect to truck-
ing, rail and other industries.

The point of this is that excessive competition at that time was under-
stood to be the cause of depression. Depressions are not caused by
protectionism, lack of liquidity, anti-Semitism (as one Nobel Laureate
economist would put it), nor by stupid managers, nor by lazy workers.

A few notes on what has happened in recent years. Air fares have
not declined. Despite the invention of hypothetical data by think tanks,
including a famous one in this town, the relationship between average
fares paid and the consumer price index is the same as it has been for
about 50 years. The fares go up on the average much less than prices in
general go up.

Yes, there are lots of discount fares and there are all sorts of inequi-
ties built in to the system, with people paying very, very high fares on the
equivalent of captive routes, and lower fares on the tourist routes.

There is poor service, and it is increasingly getting worse. There are
monumental inefficiencies in the airlines these days because of the most
grossly inefficient pattern of operation ever devised; everybody is using
hub spoke systems and asking travelers, for example, to travel from Pitts-
burough to Denver and Los Angeles by going through Newark. The conges-
tion which the National Transportation Safety Board constantly warns
about and which Congress is getting upset about is itself a by-product of
deregulation.
I acknowledge that in the scheduled airlines there are no more fatalities yet than there used to be. But this has always been the case except for really unusual periods, such as immediately following World War II, when we had something like 3,000 airlines trying to start up. You don't usually get a really statistical measure in the airline business; you have to investigate individual accidents.

As the former Safety Chief of the National Transportation Safety Board has been trying to argue again and again, many recent airline accidents bear the footprints of deregulation. This ought to be well known around Washington, but it is ignored.

There are incredible fines being levied by the Federal Aviation Administration for violations of safety, and it is no answer to say that the FAA is doing their job for the first time.

As in the saturated airports now, we are stumbling into rereregulation via regulation of landing slots and terminal gates. This is a form of regulation that is tougher to carry out than any ever done before. If Pan American, for example, pulls out of the shuttle routes because it loses too much money on the shuttle routes between Boston and Washington, will the Department of Transportation have to insist that yet another competitor go in there with yet the same number of flights on that route and lose the same amount of money in order to preserve competition?

With respect to trucking, I finally did hear one bit of common sense here, that there seems to be a decline in safety. Yes, there are low rates. Yes, there is a great deal of union busting, but nobody ever loved the Teamsters.

As Mr. Fryer pointed out, watch television from night to night and you'll hear it all the time; where the drivers come on television and say, "I don't want to drive 25 hours nonstop. I don't want to pop pills. I want to drive within the rules. But, if I do, I'll go out of business."

You cannot blame this on greedy firms and drivers. You cannot blame it on bad apples. It borders on criminal negligence to take no note of this and to say that all that all we need do is pass a law asking for enforcement of safety regulations. When everybody feels compelled to cheat, an army of inspectors cannot find them all.

Bipartisan union busting is all over the place these days. You find that Northwest and Republic, where we have two-tier labor systems, you are getting what some people predicted when you have greatly unequal pay for equal work. The tension in the cockpit and the tension in the crew business and the tension around the airline becomes unmanageable. Sheer hatred takes over, and you are even getting reports of sabotage.

The problem is not restricted to transportation industries. I do not believe that bank managers, for example, are born criminals. But when
there is intensive deregulation and competition in the banking business and when you must fight to get depositors’ money, you will launder the money that comes in your front door because you believe your competitor will launder it. In so doing, you fail to report large cash deposits to the government, thereby aiding and abetting the drug trade That’s criminal negligence.

The same thing is true with respect to Wall Street. I note that Mr. Shad is the head of a group that wants to provide $30 million to Harvard to study Ethics. When you have intensive competition, people are going to cheat. We have recent cases of that in research grants at Harvard. If you have a lot of competition for the money on the research grants, you’ll lie a little bit when the research is involved.

Now all I’m saying is: Ethics is the first loser when you have all out, complete competition across-the-board — unregulated competition.

My experience is a little bit different than was portrayed by at least one speaker on the previous panel. My experience has been that Congressional committees, when pursuing a given course, do not look closely for all the information and lots of people who cannot be clearly identified as pro-deregulation are simply not asked to testify.

Monumental research was available before regulatory reform of the trucking industry to show that in the long period of time since the regulation of the trucking industry, the safety records of the exempt truckers — and there’s always been a lot of them, as you all know — the safety records of the exempt truckers were incomprehensibly worse than those of the regulated truckers.

By flooding the roads now with more and more independent truckers, we have simply multiplied that. The States are overwhelmed because the federal government wants to get out of the safety business and the States can’t afford to take it over.

It took Great Depressions to bring regulation in earlier times. It took a Depression in the Middle West on the farms in the 1880’s, and it took the Great Crash of the 1930’s.

We have now, since 1975, the third worst record on unemployment rates in the past century. Things have been worse only during the Great Depressions of the 1890’s and the 1930’s. Most of our industrial partners are worse off than we are, and Japan’s unemployment now is rising quickly enough now to approach social crisis for that country.

Taking the two Great Depressions of the past century and what historians said about them and what concerned Presidents said about them, it seems that there is no answer to such problems except to restrict or restrain competition in some way in a whole host of industries, and that
this is not an individual problem for a given society but it's a multi-lateral and, indeed, almost global problem.

It may not be possible. I grant you that. But I urge you to consider the possibility that if we had spent, and if other countries had spent the money in the 1930's that they spent in the 1940's to fight a war, and if they had spent it in the 1930's on truly massive quality of life projects — those things that we now call infrastructure, quality of life, environment, pollution control and education — if they had spent it during the thirties, there very likely would not have been a war.

Ultimately, there is no other answer, because the textbook version of economics, which on the one hand says that anything you produce can be sold and, therefore, excessive capacity is impossible, and says on the other hand that we must have maximum competition so that consumers can have the greatest number of choices, those two principles collide.

The competitive principle wins out and when it does we have depressions.

But, of course, since there's no economic definition for a depression, I suppose that's impossible, too.

Thank you.

MR. ALEXIS: Our second speaker will be Dr. Thomas Gale Moore.
THE ECONOMIC BENEFITS OF TRANSPORTATION DEREGULATION

DR. THOMAS GALE MOORE

DR. MOORE: Thank you, Marcus.

I will save my comments on Dr. Thayer’s paper until later. I must say he has an interesting perspective.

We are here today to celebrate the 100th anniversary of the founding of the Interstate Commerce Commission.

To paraphrase Shakespeare, “Friends, Truckers, Regulators, lend me your ears.” I have come here hoping to bury regulation, not to praise it. The good that regulation does lives on without it. The harm is often interred with its bones.

In all candor, I cannot say that I am delighted to celebrate the 100th anniversary of the ICC. I would feel much more comfortable at a wake.

The question posed to us today is transportation without regulation. Ah, it would be a thing of beauty, rare and precious.

Let me rephrase the title to be: What would the world be like if there had not been an ICC? Now, I don’t know. I don’t think that is knowable. However, we can get some clues of what the world would be like and what the world would be like if we followed the Administration’s proposal to eliminate the remaining controls on motor carriers.

We get this evidence from theory, and we get this evidence from observing the facts in the real world. There is no other way to approach this problem. One cannot dream up ad hoc theories of how the world works. One has to look at evidence and base it on sound theories.

So what can the theory and the evidence tell us?

Railroads in 1887 were, as Dr. Thayer correctly reported, highly com-
petitive with elements of monopoly power. Between major cities there were many railroads operating and competition was quite acute. There were areas and cities, towns, communities which were served by only one railroad, and they were subject to monopoly pricing. In effect, there was monopoly in the short haul market and competition in the long haul market.

During the period leading up to 1887, there had been a rapid increase in capacity, as Dr. Thayer pointed out. This was partly due to new industry expanding. It was partly due to large government subsidies. The federal government was subsidizing the railroad industry greatly to build and build and build. As a consequence, we did overbuild, and there was excess capacity in the railroad industry. Moreover, efficiency was improving very rapidly in the railroad industry in the nineteenth century and on into the twentieth century. As efficiency improved, we needed less capacity.

Moreover, the economy moved over time towards lighter goods, more highly manufactured goods and services, all of which meant we needed less railroad capacity. Therefore, with or without regulation, industry had to shrink.

We also know that around the turn of the century there was an invention, — a diabolical invention as far as the railroads were concerned — trucking. Trucks came and, as roads improved, they began to siphon off valuable traffic from the railroad industries. It wasn't until 1935 that federal regulation was imposed upon the trucking industry. Actually, in 1934, the American Trucking Association said in a petition to President Roosevelt that regulation would increase costs and reduce efficiency, and they were right.

I want to bring to your attention a fact that most of you are aware of, that the Motor Carrier Act in 1935 exempted agriculture. Why did it exempt agriculture? Because farmers are probably the single most influential political group in the country. They, then and now, have been able to get many favors.

Why did they see it as a favor to exempt trucking of agricultural products? They knew they would get lower rates and better service with exempt trucking.

The major supporter of bringing trucking under control was the railroads and the Interstate Commerce Commission, which saw its mandate as fostering a prosperous railroad industry. By reducing competition of truckers, it would do that.

Over the next 50 years, regulation fostered monumental amounts of inefficiency in the trucking industry — this has been well-documented — trucks being forced to go miles out of their way because of circuitous
routing required by the ICC, trucks forced to return empty because they have no return authority. Rates were much inflated over this period, and service quality deteriorated.

There were several natural experiments during this period. Two court decisions in the 1950s deregulated frozen fruits and vegetables and fresh and frozen poultry. The Department of Agriculture studied what had happened when those items were deregulated. Rates went down sharply and, according to shippers, the service quality improved.

Australia is a good example of what would happen had there been no regulation of trucking. Australia has not had interstate trucking regulation since the early 1950s, and it operates fine. I spent some time in Australia, and they are very happy with unregulated trucking.

The United Kingdom deregulated trucking in the late '60s, they now have no economics regulations whatsoever of trucking, and it operates fine. There is no agitation to bring back regulation.

Regulated rates in the United States and Germany, which are the two most regulated trucking industries in the world, are significantly higher than regulated rates in the UK and the Netherlands, which are either unregulated or lightly regulated.

Since the late 1970's, we have been running an experiment in the United States. The federal government deregulated air freight in 1977. We deregulated air passengers in 1978, and trucks and railroads were partially deregulated in 1980. Actually, deregulation started about a year before those dates, because that is when the ICC or the CAB started the process.

What has been the effect? Virtually all the empirical studies have concluded that the results are excellent. Rates are down, service quality is improved. Contrary to what Dr. Thayer has been saying, efficiency is increased. Both for airlines and railroads, profits have actually gone up, and for trucks, the one area where profits have gone down, that was because there were significant monopoly profits in trucking, and they have been eliminated.

Logistics costs, which are the cost of inventories, cost of shipments, speed, and so on, rose steadily as a percentage of GNP, up to 1981, to reach a peak of 14.1 percent, and it has fallen since then to 11.3 percent.

This is largely due to the ability of firms to reduce their inventories, because they can get quicker service or more immediate service, from their suppliers. Total inventory levels in the United States have declined, and the cost of shipments have gone down. This saving has been estimated to be on the order of $56 billion.

Apparently deregulation or partial deregulation of the trucking industry has not hurt the industry, in the sense that there are as many or more
Class 1 carriers. There are also many more carriers in general. The number of total carriers has increased quite remarkably. Including Class 3 carriers, the number has gone from 14,600 in 1980 to something like 30,000.

Over the seven years of partial deregulation there has been a large group of new firms entering the trucking industry. This does not suggest that the trucking industry is a sick industry. Sick industries shrink, not expand.

In 1980, there were no firms that operated in all of the lower 48 states. Now we have about 4000 carriers that have that authority. Just think about what improvement in service that means. That means an improvement in competition, but also in service. One trucking firm now can offer to a shipper service throughout the lower 48 United States where they couldn’t before this.

What has happened to rates over this period of time? Rates have declined. The truckload average revenue per ton in 1985 dollars was rising steadily up to 1980 and has fallen steadily since. The average revenue per ton shows essentially the same story, that rates have, in fact, declined. There are many, many studies that have documented these gains. As I said earlier, I know of no empirical study that has produced negative results.

A few years ago, I did a survey of shippers. Shippers reported that their rates in 1982 on trueblood shipments were down 24 percent since deregulation; LTL rates were down 14 percent.

Harbridge House did a survey of 2200 manufacturers, and found that 75 percent of them favored deregulation, 65 percent reported lower rates. They reported carriers were more willing to negotiate service and rates. The Federal Trade Commission found increased pressure on rates, increased productivity.

The ICC looked at service to small communities, found no dramatic change. Complaints had decreased significantly. Rates to and from small communities have increased less rapidly than rates to and from larger cities.

Donald Harper, University of Minnesota’s School of Management, did a study of truckers and shippers in the Twin City area. He reported that the benefits to shippers were more competition, more carriers available, lower rates, more flexibility.

GAO has testified that the Motor Carrier Act had a generally favorable effect. From 1980 to October 1983, rates charged by LTL carriers fell 10 to 20 percent. There has been no adverse effect on service to small communities. Most shippers reported rates have risen only as fast as the price level or have declined.
One major effect was to reduce the value of certificates of public convenience and necessity. These certificates are like medallions on taxis in New York. Before deregulation they were worth on average around $500,000. After the act, when you had virtually free entry, they became almost worthless. Those certificates reflected monopoly gains, and deregulation eliminated those monopoly gains.

The survey of shippers that he conducted asked how they liked deregulation. In seven dimensions of quality, including quality of trucks, reliability, promptness, twice as many of them reported that service improves as reported that it got worse. So, rather than having quality go down with deregulation, it apparently has gone up. There has been a decline of complaints by shippers to the ICC.

Some claim that deregulation has hurt safety. Dr. Thayer claimed this. The data on trucking is quite poor, and one has to take that into account. Different studies come up with different results.

The best data is the FARS data — that is, the Fatal Accident Reporting System data. The problem is we don’t know how many miles trucks traveled. We have some data, but I must admit it is not good.

The fatality rate, using FARS data, since 1980 has come way down. That is hardly consistent with the idea that safety has been made worse by deregulation. Fatality Rates were going up prior to deregulation and have fallen very sharply since then. Train accidents, which are better reported, per million train-miles have fallen very sharply.

So the statistics, for what they are worth — and I confess they are not the greatest in the world — suggest that safety has, if anything, become better.

There are other statistics that show an increase in accidents. In 1982, there was legislation passed that permitted double trailers on the highway. Double trailers are inherently more dangerous and are going to cause more accidents. If there has been an increase in accidents, which is unclear, how much is due to deregulation and how much is due to the 1982 legislation?

Turning to the railroad industry, in the 1970’s railroads were on the verge of bankruptcy and nationalization. In fact, Conrail had been nationalized. Thank God, we are just about to denationalize it.

Railroads, however, due to the Staggers Act, are now prospering, but shippers also gained. Rates are down.

The study of shippers referred to above indicated that rates were down 7 percent in real terms from prederegulation. According to BLS data, since deregulation rates have moved up just with inflation. Prior to deregulation rates were moving up faster than inflation. But the BLS data does not take into account discounts and contract rates, which have be-
come much more prominent since deregulation. So the actual transaction rates must have gone down. Average revenue per ton that the railroads have reported since 1980 has dropped 4 percent, while in the previous five years it went up significantly.

Notwithstanding the decline in rates, profits are up. 1984 was the most profitable year in the railroads' history, with the railroads earning over $2.5 billion. Their return on net investment in the five years from 1980 to 1984 was over twice as high as the previous five years, even though 1981-82 was a recession year, the worst in the postwar period.

Costs have fallen faster than revenues. Operating expenses have declined some 26 percent from 1980 to 1985, while traffic volume has remained roughly constant. This is not consistent with the view that deregulation and competition pushes up costs and makes things more inefficient.

Railroads are operating more efficiently, largely because of their new ability to price their services flexibly. Prior to deregulation, railroads had to treat all their customers identically. They couldn't distinguish between customers within classes even though their costs were quite different. Now, they can do that.

Railroads have freedom to contract. They can negotiate both service and rates with individual shippers, and restrictions on intermodal transportation have been reduced, particularly with motor carriers. These changes have led to large efficiencies.

The remaining regulations — there's lots of remaining regulations of railroads — are costly. Regulations of car-hire rates, for example, have led to excess freight cars. Until the recent tax reform act, it was very profitable tax shelters to invest in freight cars. Even today, empty or full, railcars make money because of the high car-hire rates.

Actually, the high car-hire rates guarantee that an excess of freight cars and, at the same time, guarantee that they are not going to be where they are needed most. Both surpluses and shortages result.

In 1981 it was estimated that there was a surplus of some 80,000 cars. If there had been no transportation regulation — the question we were asked to answer — we would not have those surplus cars today. We would have a more integrated transportation system. Without regulation and Congressional interference, labor contracts would be more flexible and less costly. Some sale of short lines to small railroads would probably not have taken place. Railroads could have continued to operate those themselves.

For trucking, the economy still suffers from regulation. Intrastate regulation still exists which imposes significant costs. For example, it costs
over 30 percent more to ship a truckload of blue jeans from El Paso to Dallas than from Taiwan to Dallas.

At the ICC over one million tariffs are filed every year. No one looks at those tariffs. It is just a waste.

The Commission is still in the business of granting authority to enter the industry. The trucking industry operates well without regulation in many parts of the world, including parts of the United States. Therefore, the United States could have a trucking industry without regulation. It would be better.

If the government had never regulated transportation, United States income and GNP would be higher and prices would be lower. We would all be living better, especially the poor, who are most adversely affected by higher retail prices.

Thank you.
MR. ALEXIS: Our plan is to give Dr. Thayer five minutes to respond to Dr. Moore and then to give Dr. Moore five minutes in rebuttal and then to open it up for discussion.

DR. THAYER: Just one or two. My experience has been that the word "empirical" is greatly misused in this business, and it is often used to compare real data against hypothetical data. Hypothetical data are not empirical data, and trends don't mean very much unless you are specifying that the exact mix of freight being moved is the same and that nothing has changed in the industry overall.

Now, I had thought by this time — but I have heard it all day today — I had thought by this time that it was understandable to people in Washington that more trucks come into Washington with cargo than go out or that more cargo comes in than goes out because this is not a big industrial area, and so I had thought that this business of empty backhaul might have been laid to rest years ago.

But I notice that Director Miller was making the same speech he made with Senator Kennedy on television eight years ago and saying that there were piles of cargo, hypothetically, sitting around Washington that couldn't move because people didn't have backhaul authority. Freight doesn't distribute itself evenly.

Over-capacity in the case of the rail industry has been blamed a couple of times today on government intervention and subsidy. The over-capacity in the world today, which is widely recognized on the business pages and in the journals across the world but is not recognized by economic analysts and for the most part by editorial writers, is not confined to
industries on government subsidies and never has been. It is simply a byproduct of competition.

I am glad Mr. Moore made the case that also in 1935 the trucking industry did not make a good case for regulation. It is one of the myths of history that the industries always make the case for regulation. They don’t.

One other thing, and only one, I didn’t mean to imply that the gross inefficiencies in the airline business have driven up the costs. You can drive down the costs by turning to cheap labor. You can drive down the costs by cutting corners on maintenance and hope that you don’t get caught by a lot of people being killed. You really have to understand the environment that causes people to cheat.

I do get a little angry, because I think we ought to be beyond saying that everything is fine until we have thousands of people killed, and that until that happens, we won’t look at any other evidence.

But I don’t mean to say that airlines have not cut their per mile costs. They have, but they are doing it in a grossly inefficient operation and they are doing it, of course, in one of the typical ways, which is breaking the backs of labor.

That is easy to do if you keep unemployment high enough, and that is our current policy. Our current policy, liberal and conservative, is to maintain high unemployment so that we keep the wage rates down.

Thank you.

MR. ALEXIS: Tom?

DR. MOORE: Thank you.

Dr. Thayer claims that competition produces inefficiency and excess capacity. He will will discover that after deregulation the load factor for airlines increased and has been steadily higher than it has been at any time prior to deregulation. This suggests that the airlines are doing better. They have less excess capacity now than before.

Moreover, airlines now are putting more seats into the planes. If you added the additional seats per plane, capacity utilization would go up even more. Airlines are becoming considerably more efficient. This increase in capacity utilization explains fares while making more money.

So, competition and deregulation do not lead to excess capacity. Dr. Thayer shouldn’t just assert that. There should be some evidence. These numbers are not hypothetical; they are real numbers.

DR. THAYER: No, they are not.

DR. MOORE: Now, Dr. Thayer talks about competition reducing ethics, producing cheating, fraud, embezzlement, et cetera.

I always thought that those human failings were widespread and had
very little to do with competition. Russia has no competition, and I believe they are constantly arresting people for some of those exact failings.

Third-world countries are rampant with economies which have choked competition, yet they are rampant with cheating, fraud, and embezzlement.

So, I find the correlation between the two, ethics and competition, runs the other way. People in competitive industries are forced to be more ethical, because, if they are not more ethical, they will lose their customers.

That doesn’t mean there won’t be people that misbehave. There are always going to be people that steal, rob, murder. We can’t eliminate crime. But I suggest that competition reduces unethical behavior.

Dr. Thayer referred to the Great Depression as caused by excess competition. That is an interesting and almost novel view of the world. Most observers do not blame it on excess competition. In fact, competition was reduced in the United States just prior to the Great Depression by the Smoot-Hawley tariff, which eliminated the competition from imports. One could actually argue that the Great Depression was caused by a reduction in competition, not an increase.

DR. THAYER: I would remind you that I was quoting Hoover and Roosevelt, not myself.

DR. MOORE: Finally, I want to point out that there is no competition in the European airline market. Europeans have divided up their market in such a way that each country certifies one airline to fly between the two countries. Air France flies from Paris to Italy, and Alitalia goes back the other way. They share the market in a capacity allocation which I presume, from what Dr. Thayer says, is what he would like.

Their fares are about 20 percent higher than in the United States. Such capacity allocation may benefit their airlines, but it certainly doesn’t benefit the customer, the client. In fact, there is considerable pressure in Europe now to imitate the United States and deregulate their airlines. They have looked at our deregulation, and they have found it is a great success, and they would like to follow us.

I hardly would think we should follow them and Dr. Thayer’s advice.

Thank you.

MR. ALEXIS: We will now entertain some questions — or even very short speeches — if you are so moved.

Anyone?

VOICE: I move that we adjourn.

MR. ALEXIS: Okay, is there any other comment?

MR. ALEXIS: The motion has been made and seconded — made
and duly seconded. I can't stop acting like a chairman. Are there any nays?
    You are adjourned. Thank you, and thank you for coming.
    MR. CLEARY: I want to again thank the panel and thank all of you for coming. It has been an enjoyable day, very educational.
    MR. ALEXIS: Thank you very much, John.
    MR. CLEARY: Thank you.
    (Whereupon, at 5:00 p.m., the ICC Centennial Celebration was adjourned.)
## APPENDIX A
### COMMISSIONERS OF THE ICC

Revised March 1986

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<tr>
<th>Commissioner</th>
<th>Party Affiliation</th>
<th>State</th>
<th>Original Oath of Office</th>
<th>End of Service</th>
<th>Length of Service</th>
<th>Chairmanship</th>
<th>Remarks</th>
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<td>1. Thomas M. Cooley</td>
<td>R</td>
<td>MI</td>
<td>3-31-87</td>
<td>1-12-92</td>
<td>4 yrs 9 mos</td>
<td>3-31-87 - 9-4-91</td>
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<td>2. Wm R. Morrison</td>
<td>D</td>
<td>IL</td>
<td>3-31-87</td>
<td>12-31-97</td>
<td>10 yrs 9 mos</td>
<td>9-4-91 - 3-18-92</td>
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<td>3. Augustus Schoonmaker</td>
<td>D</td>
<td>NY</td>
<td>3-31-87</td>
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<td>3 yrs 9 mos</td>
<td>3-19-92 - 12-31-97</td>
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<td>5. Walter L. Bragg</td>
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<td>6. Wheelock G. Veazey</td>
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<td>12-20-96</td>
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<td>7. Martin A. Knapp</td>
<td>R</td>
<td>NY</td>
<td>3-2-91</td>
<td>12-12-10</td>
<td>19 yrs 9 mos</td>
<td>1-11-98 - 12-12-10</td>
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<td>10. James D. Yeomans</td>
<td>D</td>
<td>IA</td>
<td>5-2-94</td>
<td>3-6-05</td>
<td>10 yrs 10 mos</td>
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<td>11. Charles A. Prouy</td>
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<td>12-21-96</td>
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<td>D</td>
<td>KY</td>
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<td>12-31-10</td>
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<td>20. John H. Marble</td>
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<td>3-10-13</td>
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<td>6 mos</td>
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1. Omnibus Bus Reconciliation Act of 1982 decreased the size of the Commission to 5 members.
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<td>5-5-21</td>
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<td>31. Ernest I. Lewis</td>
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<td>5-5-21</td>
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<td>32. Frederick I. Cox</td>
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<td>NJ</td>
<td>9-1-21</td>
<td>12-31-26</td>
<td>5 yrs 4 mos</td>
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<tr>
<td>33. Frank McManamy</td>
<td>D</td>
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<td>7-1-23</td>
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<td>5 yrs 5 mos</td>
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<td>35. Richard V. Taylor</td>
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<td>36. Ezra Brainerd, Jr.</td>
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<td>2-23-27</td>
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<td>6 yrs 10 mos</td>
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<tr>
<td>37. Claude R. Porter</td>
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<td>1-28-28</td>
<td>8-17-46</td>
<td>18 yrs 6 mos</td>
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<td>38. Patrick J. Farrell</td>
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<td>41. Charles D. Mahaffie</td>
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<td>24 yrs 3 mos</td>
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<tr>
<td>42. Carroll Miller</td>
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<td>6-14-33</td>
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<td>16 yrs 6 mos</td>
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<td>43. Walter M. W. Splawn</td>
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<td>6-30-53</td>
<td>19 yrs 4 mos</td>
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<td>44. Marion M. Caskie</td>
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<td>8-26-35</td>
<td>3-31-40</td>
<td>4 yrs 7 mos</td>
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<td>45. John L. Rogers</td>
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<td>46. J. Haden Allredge</td>
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<td>10-31-55</td>
<td>16 yrs 6 mos</td>
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<td>47. William J. Patterson</td>
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<td>ND</td>
<td>7-31-39</td>
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<td>13 yrs 11 mos</td>
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<tr>
<td>J. Monroe Johnson</td>
<td>D</td>
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<td>6-3-40</td>
<td>6-4-56</td>
<td>16 yrs</td>
<td>1-1-50 - 12-31-50</td>
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<td>George M. Barnard</td>
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<td>12-2-44</td>
<td>1-1-49</td>
<td>4 yrs 1 mo</td>
<td>7-1-54 - 6-30-55</td>
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<tr>
<td>Richard F. Mitchell</td>
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<td>2-3-47</td>
<td>6-15-59</td>
<td>12 yrs 4 mos</td>
<td>7-1-55 - 11-25-55</td>
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<tr>
<td>Hugh W. Cross</td>
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<td>IL</td>
<td>4-11-49</td>
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<td>6 yrs 7 mos</td>
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<tr>
<td>James K. Knudson</td>
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<td>UT</td>
<td>4-20-50</td>
<td>5-22-54</td>
<td>4 yrs 1 mo</td>
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<td>Kelso Elliott</td>
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<td>Anthony F. Arpaia</td>
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<td>7-11-52</td>
<td>3-15-60</td>
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<td>Owen Clarke</td>
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<td>7-10-53</td>
<td>1-15-58</td>
<td>4 yrs 6 mos</td>
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<td>Howard G. Freas</td>
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<td>CA</td>
<td>8-18-53</td>
<td>12-31-66</td>
<td>13 yrs 4 mos</td>
<td>1-1-59 - 12-31-59</td>
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<td>Kenneth H. Tuggle</td>
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<td>KY</td>
<td>9-8-53</td>
<td>7-31-75</td>
<td>21 yrs 10 mos</td>
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<tr>
<td>John H. Winchell</td>
<td>R</td>
<td>CO</td>
<td>7-28-54</td>
<td>4-3-61</td>
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<td>1-1-61 - 12-31-61</td>
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<tr>
<td>Everett Hutchinson</td>
<td>D</td>
<td>TX</td>
<td>2-1-55</td>
<td>3-31-65</td>
<td>10 yrs 2 mos</td>
<td>1-1-61 - 12-31-61</td>
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<tr>
<td>Rupert L. Murphy</td>
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<td>GA</td>
<td>12-30-55</td>
<td>8-31-78</td>
<td>22 yrs 8 mos</td>
<td>1-1-62 - 12-31-62</td>
<td>3-1-61 - 12-31-61</td>
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<td>Robert W. Minor</td>
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<td>OH</td>
<td>2-15-56</td>
<td>9-4-58</td>
<td>2 yrs 7 mos</td>
<td>1-1-63 - 12-31-63</td>
<td>1962</td>
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<tr>
<td>Laurence K. Wairath</td>
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<td>FL</td>
<td>3-29-56</td>
<td>6-30-72</td>
<td>15 yrs 3 mos</td>
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<td>Donald P. McPherson, Jr.</td>
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<td>Abe McGregor Goff</td>
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<td>7-31-67</td>
<td>9 yrs 5 mos</td>
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<td>1965</td>
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<td>Charles A. Webb</td>
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<td>4-1-67</td>
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<td>Clyde E. Herring</td>
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<td>William H. Tucker</td>
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<td>Paul J. Tierney</td>
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<td>MD</td>
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<td>Virginia Mae Brown</td>
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<td>WVA</td>
<td>5-25-64</td>
<td>7-29-79</td>
<td>15 yrs 2 mos</td>
<td>1-1-73 - 12-31-73</td>
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1. This Office created March 1, 1961. No Vice Chairman from 7-21-79 to 8-5-79 between Brown and Stafford.
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<tr>
<td>71. Willard Deason</td>
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<td>9-8-65</td>
<td>7-31-75</td>
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<td>72. George M. Stafford 2</td>
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<td>KS</td>
<td>4-26-67</td>
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<td>13 yrs 4 mos</td>
<td>1-1-70 - 4-4-77</td>
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<td>73. Grant E. Syphers</td>
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<td>CA</td>
<td>7-31-67</td>
<td>2-5-68</td>
<td>6 mos</td>
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<td>74. Dale W. Hardin</td>
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<td>7-31-67</td>
<td>8-31-77</td>
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<td>75. Wallace R. Burke</td>
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<td>76. Donald L. Jackson</td>
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<td>6-30-74</td>
<td>3 yrs 11 mos</td>
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<td>79. Chester M. Wiggins, Jr.</td>
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<td>10-24-72</td>
<td>7-31-73</td>
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<td>80. Alfred T. MacFarland</td>
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<td>11-3-72</td>
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<td>83. Charles L. Clapp</td>
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<td>84. Robert J. Corber</td>
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<td>3-13-75</td>
<td>12-1-76</td>
<td>1 yr 9 mos</td>
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<td>85. Betty Jo Christian</td>
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<td>12-31-79</td>
<td>3 yrs 8 mos</td>
<td>1978</td>
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<td>86. Thomas A. Trantum</td>
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<td>7-23-79</td>
<td>7-31-81</td>
<td>2 yrs</td>
<td>8-13-81 - 12-31-81</td>
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<td>87. Darius W. Gaskins, Jr.</td>
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<td>7-23-79</td>
<td>2-1-81</td>
<td>1 yr 6 mos</td>
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<td>88. Marcus Alexis</td>
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<td>7-1-81</td>
<td>10 mos</td>
<td>1-1-81 - 6-30-81</td>
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<td>89. Reginald E. Gilliam, Jr.</td>
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2. First Presidnently Appointed Chairman
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<th>Chairmanship</th>
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<th>Remarks</th>
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<td>R</td>
<td>NV</td>
<td>6-25-81</td>
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<td>9-10-84</td>
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<td>12-31-88</td>
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<td>95. Paul H. Lamboley</td>
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<td>NV</td>
<td>9-11-84</td>
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<td>12-31-90</td>
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<td>96. Andrew J. Strenio, Jr.</td>
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<td>MD</td>
<td>9-14-84</td>
<td>12-31-85</td>
<td>1 yr 3 mos</td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td>P.L. 97-253. ^</td>
</tr>
</tbody>
</table>

1. No Vice Chairman between 6-30-81 and 8-12-81 after Acting Chairman Alexis left until Commissioner Clapp was appointed Vice Chairman.
2. Omnibus Bus Reconciliation Act of 1982 decreased the size of the Commission to 5 members.
APPENDIX B

TWELVE POINT PRIMER

BY

Honorable
JOSEPH B. EASTMAN

From His Response
At a Silver Anniversary Celebration
Held in His Honor February 17, 1944
Sponsored by the
Association of Interstate Commerce
Commission Practitioners
(1) With the country as big and complex as it is, administrative tribunals like the Interstate Commerce Commission are necessities. Probably we shall have more rather than less. To be successful, they must be masters of their own souls, and known to be such. It is the duty of the President to determine their personnel through the power of appointment, and it is the duty of Congress to determine by statute the policies which they are to administer; but in the administration of those policies these tribunals must not be under the domination or influence of either the President or Congress or of anything else than their own independent judgment of facts and the law. They must also be in position and ready to give free and untrammeled advice to both the President and Congress at any time upon request. Political domination will ruin such a tribunal. I have seen this happen many times, particularly in the States.

(2) The courts were at one time much too prone to substitute their own judgment on the facts for the judgment of administrative tribunals. They are now in danger of going too far in the other direction. The principle that it is an error of law to render a decision not supported by substantial evidence is a salutary principle. The courts should enforce it.

(3) An administrative tribunal has a broader responsibility than a court. It is more than a tribunal for the settlement of controversies. The word “administrative” means something. The policies of the law must be carried out. If in any proceeding the pertinent facts are not fully presented by the parties, it is the duty of the tribunal to see to it, as best it can, that they are developed of record. A complainant without resources to command adequate professional help should be given such protection. The tribunal should also be ready to institute proceedings on its own motion, whenever constructive enforcement of the law so requires.

(4) There is no safe substitute in the procedure of the tribunal for full hearing and argument of the issues, when they are in controversy, although the hearing need not always be oral. This takes time, but it is time well spent.

(5) The decisions of the tribunal should present succinctly the pertinent facts, as they are found to be, and the conclusions reached, but also state clearly the reasons for the conclusions.

(6) The statutes which the tribunal administers should be well, simply, and carefully framed, but the personnel which does the administering is more important than the wording of the statute. Good men can produce better results with a poor law than poor men can produce with a good law.

(7) It is not necessary for the members of the tribunal to be techni-
cal experts on the subject-matter of their administration. As a matter of fact, you could not find a man who is a technical expert on any large part of the matters upon which the Interstate Commerce Commission finds it necessary to pass. The important qualifications are ability to grasp and comprehend facts quickly, and to consider them in their relation to the law logically and with an open mind. Zealots, evangelists, and crusaders have their value before an administrative tribunal, but not on it. Other important qualifications are patience, courtesy, and a desire to be helpful to the extent that the law permits.

(8) Moral courage is, of course, a prime qualification, but there are often misapprehensions as to when it is shown. The thing that takes courage is to make a decision or take a position which may react seriously in some way upon the one who makes or takes it. It requires no courage to incur disapproval, unless those who disapprove have the desire and the power to cause such a result. Power is not a permanent but a shifting thing. I can well remember the time when it was a dangerous thing to incur the displeasure of bankers, but there has been no danger in this since 1932. It became a greater danger to incur the displeasure of farm or labor organizations. There is nothing more important than to curb abuse of power, wherever it may reside, and power is always subject to abuse.

(9) Selection of the members of an administrative tribunal from different parts of the country has its advantages, but they turn to disadvantages, if the members regard themselves as special pleaders for their respective sections.

(10) Sitting in dignity and looking down on the suppliants from the elevation of a judicial bench has its dangers. A reversal of the position now and then is good for the soul. It has for many years been my good fortune to appear rather frequently before legislative or congressional committees. They are a better safeguard against inflation than the O.P.A.

(11) In any large administrative tribunal, like the Interstate Commerce Commission, a vast amount of the real work must necessarily be done by the staff. It is a difficult problem to give the individual members of the staff proper recognition for work well done—recognition on the outside as well as the inside. It is very important that this problem be solved, but I am frank to say that its full solution has not yet been reached.

(12) One of the great dangers in public regulation by administrative tribunals of business concerns is the resulting division of responsibility, as between the managements and the regulators, for the successful functioning of these concerns. For example, there was a tendency at one time, and it may still exist, on the part of those financially interested in the railroads to think of the financial success of those properties solely in terms of rates and wages and the treatment of rates and wages by public
authorities. Sight was lost of the essentiality of constant, unremitting enterprise and initiative in management. The importance of sound public regulation cannot be minimized, but it must not be magnified to the exclusion of those factors in financial success upon which ordinary private business must rely.
Airline Deregulation—A Case Study
in Public Policy Failure

MELVIN A. BRENNER*

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* Over forty years of aviation experience, divided between government, airlines, and independent consulting. Airline industry positions (1955-1977) included: Vice President of Market Planning for American Airlines and for TWA. Government positions (1945-1955) included: Assistant to Vice Chairman of Civil Aeronautics Board; Transportation Specialist, Bureau of the Budget; Aviation Adviser to the Under Secretary of Commerce. Consulting activity (since 1977) has included projects for a wide variety of large and small airlines, both within the U.S. and in varied regions of the world.
I. INTRODUCTION**

The years 1986-87 witnessed important new developments in the evolution of airline deregulation. These included sweeping structural changes, with a waive of mergers that has rarely been matched in any other industry. Fifteen of the carriers operating independently at the start of 1986 had become six carriers by the end of 1987. Of particular significance within this wave of mergers was the lost independence of the one carrier that had been almost the prototype of deregulated free entry—People Express.

Secondly, there emerged in 1987 severe public dissatisfaction with congestion, delays, and other aspects of weakened service quality—leading to a series of congressional hearings to consider possible legislative action. Meanwhile, the Department of Transportation has issued rules requiring, among other things, that carriers make available information on the degree of dependability of their operations. More generally, carriers by the latter half of 1987 were placing more emphasis on service quality—in some cases spending hundreds of millions of dollars to overcome service deficiencies.

In view of the sweeping nature of the structural changes of the past two years, and the recent re-focusing on service quality, it is still not possible to render a final verdict from the public’s standpoint on the long term outcome of deregulation. However, it is possible to clarify certain aspects

** The Transportation Law Journal is not responsible for the accuracy of statistical data contained in this article.
of the record to date. Because of the inherent disposition to resent government interference and to favor free markets, there has been a general tendency to overstate the favorable accomplishments of deregulation and to downplay its defects. This tendency has particularly shown up in the failure to compare trends since deregulation with previous trends—for example, to note that fare declines of recent years have been basically an extension of trends well established under regulation.

Furthermore, there is a tendency to forget the basis on which deregulation was justified to Congress and the extent to which subsequent reality has deviated from those original promises. Such deviation might be dismissed as having merely historical relevance were it not for one important point. Nine years of deregulation experience demonstrate that the widespread academic support for deregulation rested on a number of misconceptions as to the true dynamics of the airline marketplace. There is value in identifying the flawed premises of deregulation, to guard against future policies stemming from those same premises.

There have, of course, been benefits from deregulation. Probably the most important has been the removal of governmental second-guessing, and the consequent release of managerial initiative and creativity to function without hindrance. The opportunity for hub-and-spoke development, with associated benefits of increased frequencies for many city-pairs, has been another important benefit. The fuller development of secondary, "satellite" airports within major metropolitan areas is still another.

However, just as there is "no free lunch," these benefits did not come free. To date, there has been inadequate recognition of the penalties that have been involved, or which yet may develop. One of the paradoxes of this industry is that it publishes the most detailed statistical record of its operations and finances of any industry in our economy—and yet that record is rarely reviewed for the insights it can provide as to what makes this business "tick." Behavioral patterns of the industry (e.g., its persistent problems of over-capacity and fare wars) seem irrational unless and until one recognizes the special dynamics of its marketplace. This article points to some of the insights derivable from the past and recent record, which particularly raise questions as to whether indeed the best long term result (for the public itself) can be assured by the totally unrestrained workings of the free market.

This does not mean that re-regulation is feasible to the full degree that existed before 1978. However, it does mean that possibilities for some middle ground may have to be considered—some compromise between the full-scale regulation of pre-1978 and the full-scale free market of today.
II. RECENT EXPRESSIONS OF CONCERN

After nearly a decade of airline deregulation, growing signs of disenchantment with this new environment began to show up in 1986 and 1987. In December 1986, a cover story in Business Week was headlined: "Is Deregulation Working?" The basic thrust of the article was that it is not. In January 1987, a study by the Transportation Center of Northwestern University concluded that deregulation "may have become merely a vehicle for transforming a publicly regulated oligopoly into a private oligopoly or cartel." In May 1987, Air Transport World noted: "less than 10 years after airline deregulation in the U.S., the experiment appears in trouble with Congress. . . . The threat of limited re-regulation is real. . . ." Travel Weekly reported: "Senate aviation leaders warned top [airline] officials . . . that they are in a mood to legislate better air service. . . . Chairman Ernest Hollings said the government is going to have to 'come in and do some reregulation.' "

Deregulation has not performed in the manner promised by its sponsors. In particular, it has departed from those promises in the following respects:

- **Promise:** Deregulation would provide wide-open competition, with the free entry of new firms "policing" the market, and assuring adequate, reasonably-priced service.
  **Fact:** Bankruptcies, mergers, and acquisitions, have led to an industry more tightly concentrated into a few large carriers than was the case under regulation. There is little future prospect for any significant competitive challenge by a new entrant.

- **Promise:** Deregulation would bring substantial fare reductions.
  **Fact:** While there have been dramatic reductions in some individual markets, the average fare level has not improved significantly compared with trends under regulation.

- **Promise:** The benefits of deregulation would be equitably distributed—and markets that lacked their own direct competition would benefit from the constant threat of competition from new entrants.
  **Fact:** Considerable inequities have developed between fares in markets with limited competition vis-a-vis fares in more intensely competitive markets.

- **Promise:** Deregulation would provide the public with new price/service options, such as lower-fare, no-frills service.
  **Fact:** By early 1987, specialized no-frills carriers no longer occupied a significant market position.

---

• **Promise:** Deregulation would lead to greater efficiency and lower cost.  
**Fact:** Deregulation did lead to lower labor costs—but this was substantially offset by hidden costs and inefficiencies in other factors of production (e.g., congestion and delay costs due to intense hub-and-spoke scheduling; start-up and shut-down costs of unstable route structures; less-than-optimum seat-mile costs because of pressure for smaller planes).

• **Promise:** By providing freedom to compete in pricing, deregulation would obviate the previous need to compete in service, and would particularly eliminate scheduling pressure and resulting excess capacity.  
**Fact:** Carriers are still dependent on service and schedule rivalry in striving for competitive differentiation. Deregulation has actually increased the tendency for excess capacity.

• **Promise:** Even with free entry/free exit, the prior route network would continue to be served with little disruption.  
**Fact:** The turnover of routes has been massive.

• **Promise:** Deregulation would not create economic distress for the industry.  
**Fact:** Deregulation has been responsible for years of heavy industry losses and dozens of jet carrier bankruptcies, plus many more bankruptcies of commuter carriers.

As already indicated, these comments are not meant to imply that deregulation has been entirely negative in its impact. However, most of its benefits could have been obtained with judicious relaxation (instead of total abandonment) of regulation. Prior to 1978, the Civil Aeronautics Act and its amendments gave the CAB considerable latitude in route certification and pricing. Indeed, in the years immediately before 1978, the Board did liberalize policies in those areas, while still functioning under the original regulatory statute.

The decision to go beyond liberalization and completely scrap regulation can be attributed to a number of misconceptions regarding the dynamics of the air transport marketplace. Deregulators were confident that this industry satisfied the criteria for viable free market competition, without any need for moderation of free market forces. Nine years of actual experience indicate that there are instead special characteristics of this industry which make more suitable the partial "public utility" approach embodied in the original Civil Aeronautics Act.

It is clearly impossible to turn the clock back and reconstruct the framework of that statute. Equally clear, the congressional dissatisfaction displayed in 1987 may well lead to some degree of re-regulation. It is therefore relevant to consider how and why deregulation has deviated from its sponsors' expectations, if only to provide a reasoned platform for considering possible future modifications.
III. INDUSTRY CONCENTRATION

A. THE TIGHTER CONCENTRATION OF DEREGULATION

In 1978, the "certificated" scheduled airline industry consisted of eleven trunk lines and eight local service airlines. Deregulators criticized the CAB for having authorized so few carriers. To encourage more competitors, the Airline Deregulation Act of 1978 included the following policy objectives: "the avoidance of unreasonable industry concentration, excessive market domination, and monopoly power" and "the encouragement of entry into air transportation markets by new carriers."

Paradoxically, nine years of free market operation have moved the industry to a tighter concentration than existed before. The prospect is that it will shortly end up with only five or six major survivors. The path to this result has been strewn with bankruptcies and mergers. Figure 1 lists principal mergers and acquisitions. Figure 2 presents a partial list of bankruptcies or terminations of operations.

In 1978, the leading six carriers accounted for 71% of industry traffic. By 1987, mergers had increased the concentration of the six top carriers to 79% (Figure 3). Even the latter is an interim figure. Further concentration must be anticipated, because some of the remaining carriers are not likely to remain independent for long. For example, the departing president of Braniff admitted that "because of the many recent mergers in the industry. Braniff might need to be acquired in order to continue operating." (More recently, in a twist on that prediction, Braniff itself sought to acquire Pan American in a proposed merger. The effect would still have been to reduce further the number of carriers remaining.)

The data in Figure 3 actually understate the de facto increase in concentration, because they deal only with scheduled airline traffic. In the past, scheduled airlines also had intense competition from nonscheduled, low-fare charter programs. In contrast, by 1987 the charter industry was a casualty of deregulation, with the original carriers either out of business or operationing greatly reduced schedules. Thus, not only is there greater concentration within scheduled service, but there is no longer vigorous competition from nonscheduled service.

This concentration is very much in line with the warnings of those who opposed deregulation. Thus, Secor Browne (former Chairman of the

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5. For example: "There were sixteen carriers operating when the 1938 Act took effect, and there has not been a single new trunk line carrier certificated in the Board's history." Snow, Aviation Regulation: A Time for Change, 41 J. Air L. & Com. 640 (1975) (Article by Deputy Under Secretary of Transportation).


<table>
<thead>
<tr>
<th>Carrier</th>
<th>Comments</th>
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<tr>
<td>Air Cal</td>
<td>into American</td>
</tr>
<tr>
<td>Air Florida*</td>
<td>into Midway</td>
</tr>
<tr>
<td>Braniff’s Latin American Division</td>
<td>into Eastern, then Texas Air</td>
</tr>
<tr>
<td>Britt</td>
<td>into People Express, then Texas Air</td>
</tr>
<tr>
<td>Continental</td>
<td>into Texas Air</td>
</tr>
<tr>
<td>Eastern</td>
<td>into Texas Air</td>
</tr>
<tr>
<td>Empire</td>
<td>into Piedmont, then US Air</td>
</tr>
<tr>
<td>Frontier*</td>
<td>into People Express, then Texas Air</td>
</tr>
<tr>
<td>Henson</td>
<td>into Piedmont, then US Air</td>
</tr>
<tr>
<td>Hughes Air West</td>
<td>into Republic, then Northwest</td>
</tr>
<tr>
<td>Jet America</td>
<td>into Alaskan</td>
</tr>
<tr>
<td>National</td>
<td>into Pan American</td>
</tr>
<tr>
<td>New York Air</td>
<td>into Texas Air</td>
</tr>
<tr>
<td>North Central</td>
<td>into Republic, then Northwest</td>
</tr>
<tr>
<td>Ozark</td>
<td>into TWA</td>
</tr>
<tr>
<td>Pan Am’s Pacific Division</td>
<td>into United</td>
</tr>
<tr>
<td>PBA</td>
<td>into People Express, then Texas Air</td>
</tr>
<tr>
<td>People Express</td>
<td>into Texas Air</td>
</tr>
<tr>
<td>Piedmont</td>
<td>into US Air</td>
</tr>
<tr>
<td>PSA</td>
<td>into US Air</td>
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<tr>
<td>Ransome</td>
<td>into Pan American</td>
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<tr>
<td>Southern</td>
<td>into Republic, then Northwest</td>
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<tr>
<td>Transtar</td>
<td>into Southwest</td>
</tr>
<tr>
<td>Western</td>
<td>into Delta</td>
</tr>
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</table>

* In bankruptcy at time of acquisition

CAB) predicted: "strong carriers would ultimately push the weak ones off the cliff." Another opponent warned of "irresistible pressure toward elimination of the smaller carrier as a competitor." Such warnings were ignored. Instead, the deregulators insisted that airline size did not affect competitive viability, and that there would remain unrestricted opportunity for new small firms to challenge the incumbents. Said the CAB staff: "There are no structural traits inherent in domestic air transportation which indicate superior performance by large-size firms; nor are there traits which would significantly inhibit the entry of new firms into the industry." The Department of Transportation concurred: "The

10. CAB STAFF REPORT, supra note 8, at 271.
Carriers Going Bankrupt or Discontinuing Operations Since 1978

| Air Atlantic | Freedom Airlines |
| Air Florida* | Frontier* |
| Air Illinois | Golden Gate Airlines |
| Air New England | Golden West Airlines |
| Air North | Imperial Airlines |
| Air One | Mackey International |
| Aeroamerica | McClain Airlines |
| Altair | Northeastern International |
| American Central | Oceanair |
| American International | Pacific East |
| Apollo Airways | Pacific Express |
| Arrow Airways | Pride Air |
| Braniff* | Southeast Airlines |
| Capitol | Swift Aire Lines |
| Cascade Airways | Transamerica |
| Cochise Airlines | Wien Alaska |
| Continental* | Wright |
| Emerald Air | World** |

Note: Does not include all commuter carrier bankruptcies.

* Subsequently renewed operations, or was acquired, after bankruptcy.

** Discontinued scheduled passenger operations only.

Evidence suggests very strongly that the optimal size of firms will be sufficiently small so that there will be room for a considerable number of competitive firms in the industry.\(^\text{11}\)

This rejection of the oligopoly scenario was absolutely basic to the deregulation rationale. It is inconceivable that Congress would have enacted deregulation if it foresaw that the public would end up with neither the protection of regulation nor the protection of wide-open multi-carrier competition.

The deregulators' belief that airline size did not matter derived from a simplistic misinterpretation of available data. Before 1978, small carriers had enjoyed relatively good financial performance compared with larger lines. Without looking for possible extenuating circumstances, the deregulators eagerly seized upon these data as establishing the broad proposition that carrier size played no part in the airline marketplace.

In fact, carrier size has always had potential market impact, but this was kept latent by regulation. The effect of size was neutralized during regulation because of the following:

- While regulated, the financial results of the largest airlines were limited by the fact that their route systems contained the greatest amount of compe-

\(^{11}\) Snow, supra note 5, at 663.
Figure 3
Concentration of Traffic in Leading Air Carriers 1978 and 1987

<table>
<thead>
<tr>
<th>Carrier</th>
<th>Percent of Industry Passenger Miles</th>
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<tbody>
<tr>
<td>1978</td>
<td></td>
</tr>
<tr>
<td>United</td>
<td>17.0%</td>
</tr>
<tr>
<td>American</td>
<td>12.5</td>
</tr>
<tr>
<td>TWA</td>
<td>11.7</td>
</tr>
<tr>
<td>Eastern</td>
<td>10.9</td>
</tr>
<tr>
<td>Delta</td>
<td>10.1</td>
</tr>
<tr>
<td>Pan American</td>
<td>9.1</td>
</tr>
<tr>
<td>Six-carrier total</td>
<td>71.3%</td>
</tr>
</tbody>
</table>

| 1987*           |                                    |
| Texas Air       | 19.4%                              |
| United          | 16.2                               |
| American        | 13.9                               |
| Delta           | 11.6                               |
| Northwest       | 10.0                               |
| TWA             | 8.1                                |
| Six-carrier total | 79.2%                        |

* Based on traffic carried in 1986, with carriers grouped in accordance with mergers completed or pending as of mid-1987:
  - Texas Air includes Eastern, People Express, New York Air, and Frontier
  - American includes Air Cal
  - Delta includes Western
  - Northwest includes Republic
  - TWA includes Ozark

Source: Derived from data of CAB and DOT.

- For example, the intense competition between United, American, and TWA on major transcontinental routes led to depressed load factors, and also to an above-average level of cost for in-flight service amenities.
- Conversely, the smallest carriers had the highest proportion of monopoly routes—receiving in some cases over 70% of their traffic in markets without any competition.\(^{12}\)
- In an effort to achieve a more balanced industry structure, the CAB tended to favor the smaller carriers in the award of valuable new routes.
- The CAB enforced a form of inter-carrier subsidization by the large carriers of the smaller ones, through the formula for division of joint ticket revenues.

More generally, regulatory practice would have prevented airline marketing programs designed to exploit network size. It is highly doubt-

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ful, for example, that the CAB during most of its existence would have permitted a marketing device such as the Frequent Flyer program, which by its nature favors carriers with large network systems.

In short, the comparative success of small airlines pre-1978 was itself a consequence of regulation, which had neutralized size as a market factor. However, the deregulators looked only at the end result rather than the cause. They thus ignored the fact that the framework they were about to dismantle was the very thing that had enabled small carriers to hold their own against larger carriers.

Belatedly—eight years after the fact—Alfred Kahn conceded the importance of carrier size. In 1986, he referred to the "enormous competitive advantages enjoyed by the very biggest carriers, most prominently American and United." He admitted that the industry was "evolving into an uncomfortably tight oligopoly," and listed factors he regarded as advantages of the largest carriers:

- "The ability that their vast networks give those two giants to feed traffic onto their own flights at the hubs they dominate;"
- "the enormous competitive advantages they have achieved through the development and exploitation of their own computerized reservations systems . . .;"
- "the superior attractiveness of their frequent flyer programs;"  
- "the effectiveness with which they have learned to meet the uniform low fares of much lower-cost competitors like People, selectively, with even more deeply discounted fares restricted to seats that would otherwise go out empty;"
- "their superior ability to last out price wars."  

In effect, Mr. Kahn thus embraced the types of arguments that opponents of deregulation had advanced eight years earlier. However, by the time he made this concession, the die had been irreversibly cast in the direction of industry concentration.

Particularly revealing is the fact that the importance of size has not been felt only by small new entrants. Even larger, established carriers have not been secure against it. Delta, TWA, and Northwest—ranked fourth, fifth, and sixth in size in 1986—concluded that their size was inadequate. Hence, they acquired Western, Ozark, and Republic respectively, to come closer to a "critical mass."

Still another indication of the importance of size was the merger of British Airways and British Caledonian Airways, announced in July 1987. Officials of those airlines indicated that they had to position themselves "to meet increasing competition from the giant airlines which have

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14. Id. at 14.
emerged over the last two years, especially in the U.S. . . . The prospects for medium-sized airlines, however good operationally, are very uncertain when ranged against the emerging power of the megacarriers, notably in the U.S. . . . 15

Thus, concern about the position of the largest U.S. carriers has spread to substantial airlines abroad. These developments underscore just how dim the outlook is for any small, new entrant attempting to make a significant dent in the U.S. market.

B. POTENTIAL IMPACT OF AIRLINE CONCENTRATION

Defenders of deregulation have recently tried to belittle the significance of the industry’s concentration by pointing out that other industries also consist of a handful of large firms. For example, Alfred Kahn has stated, “In most major industries, there is at least some concentration. Look at soft drinks. You have Coca-Cola and Pepsi-Cola and yet you have lots of price competition.” 16

However, air transport differs in one important respect. Other industries, even when comprised of only a few large firms, do not usually end up with a one-supplier monopoly in specific local markets. But this can happen in air transportation.

Moreover, because of the nature of transportation, a local monopoly can do greater harm to a community than could a local monopoly in some other industry. This is because transportation is a basic part of the economic/social/cultural infrastructure, which affects the efficiency of all other business activities in a community and the quality of life of its residents. The ability of a city to retain existing industries, and attract new ones, is uniquely dependent upon the adequacy, convenience, and reasonable pricing of its airline service.

The concentration of air service has been especially pronounced in local routes to and from hubs. Figure 4 lists principal hub airports where just one or two carriers are dominant. At five of these airports, the one-carrier domination with recent mergers has come to exceed 75% of available passengers. At three other airports, there is two-carrier domination which approaches or exceeds 90% of the passengers. For perspective, Figure 4 also indicates the much lesser concentration at these same airports in 1979, at the start of deregulation. Most of the single-carrier hubs then had less than half of their traffic in the hands of the principal carrier. (The two main exceptions were Charlotte and Houston Hobby, and the

15. TRAVEL WEEKLY, July 23, 1987, at 1, 73.
Figure 4
Dominance of Individual Carriers at Principal Hubs

<table>
<thead>
<tr>
<th>Hub Airport</th>
<th>1986 Percentage of Passengers on Dominant Carrier</th>
<th>1979 Percentage on Dominant Carrier</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Dominant Carriers</td>
<td></td>
</tr>
<tr>
<td>St. Louis</td>
<td>TWA 83%</td>
<td>44%</td>
</tr>
<tr>
<td>Pittsburgh</td>
<td>US Air 82</td>
<td>51</td>
</tr>
<tr>
<td>Charlotte</td>
<td>Piedmont 79</td>
<td>73*</td>
</tr>
<tr>
<td>Minneapolis</td>
<td>Northwest 79</td>
<td>40</td>
</tr>
<tr>
<td>Salt Lake City</td>
<td>Delta 76</td>
<td>43*</td>
</tr>
<tr>
<td>Houston (IAH)</td>
<td>Texas Air 72</td>
<td>19</td>
</tr>
<tr>
<td>Houston ( Hobby)</td>
<td>Southwest 69</td>
<td>82</td>
</tr>
<tr>
<td>Detroit</td>
<td>Northwest 68</td>
<td>20*</td>
</tr>
<tr>
<td>Newark</td>
<td>Texas Air 65</td>
<td>33*</td>
</tr>
<tr>
<td>Dayton</td>
<td>Piedmont 64</td>
<td>36*</td>
</tr>
<tr>
<td>Baltimore</td>
<td>Piedmont 59</td>
<td>25*</td>
</tr>
</tbody>
</table>

B. Two-Carrier Hubs

<table>
<thead>
<tr>
<th>Hub Airport</th>
<th>1986 Percentage of Passengers on Dominant Carrier</th>
<th>1979 Percentage on Dominant Carrier</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Dominant Carriers</td>
<td></td>
</tr>
<tr>
<td>Atlanta</td>
<td>Delta 55</td>
<td>50</td>
</tr>
<tr>
<td></td>
<td>Eastern 40</td>
<td>40</td>
</tr>
<tr>
<td></td>
<td>95</td>
<td>90</td>
</tr>
<tr>
<td>Denver</td>
<td>Texas Air 47</td>
<td>23*</td>
</tr>
<tr>
<td></td>
<td>United 42</td>
<td>27</td>
</tr>
<tr>
<td></td>
<td>89</td>
<td>50</td>
</tr>
<tr>
<td>Dallas/Ft. Worth</td>
<td>American 63</td>
<td>32</td>
</tr>
<tr>
<td></td>
<td>Delta 24</td>
<td>37*</td>
</tr>
<tr>
<td></td>
<td>87</td>
<td>69</td>
</tr>
<tr>
<td>Chicago (O'Hare)</td>
<td>United 44</td>
<td>28</td>
</tr>
<tr>
<td></td>
<td>American 28</td>
<td>21</td>
</tr>
<tr>
<td></td>
<td>72</td>
<td>49</td>
</tr>
</tbody>
</table>

* Different carrier dominant than shown for 1986.

Note: Reflects mergers already implemented or pending. Percentages are based on 1986 traffic shares.


High percentages for those two reflected mainly their very small traffic base at the time.

Figure 5 indicates specifically for one hub (Detroit) the destinations for which nonstop service is dominated or provided exclusively by Northwest Airlines. As of September 1987, there were fifty-one such destinations. Significantly, this type of concentration exists not in some very small city, but in the sixth largest metropolitan area in the country.
Figure 5

**Detroit Nonstop Markets Dominated or Served Exclusively by Northwest or Northwest Commuter Carrier, September 1987**

<table>
<thead>
<tr>
<th>Destination</th>
<th>Percentage of Nonstops by NW or NW Commuter</th>
<th>Destination</th>
<th>Percentage of Nonstops by NW or NW Commuter</th>
</tr>
</thead>
<tbody>
<tr>
<td>Akron</td>
<td>100%</td>
<td>Minneapolis</td>
<td>100%</td>
</tr>
<tr>
<td>Albany, N.Y.</td>
<td>100</td>
<td>Montreal</td>
<td>100</td>
</tr>
<tr>
<td>Allentown</td>
<td>100</td>
<td>Muskegon</td>
<td>100</td>
</tr>
<tr>
<td>Alpena</td>
<td>100</td>
<td>New York/Newark</td>
<td>67</td>
</tr>
<tr>
<td>Battle Creek</td>
<td>100</td>
<td>Pellston</td>
<td>100</td>
</tr>
<tr>
<td>Boston</td>
<td>100</td>
<td>Peoria</td>
<td>100</td>
</tr>
<tr>
<td>Buffalo</td>
<td>100</td>
<td>Phoenix</td>
<td>100</td>
</tr>
<tr>
<td>Cedar Rapids</td>
<td>100</td>
<td>Providence</td>
<td>100</td>
</tr>
<tr>
<td>Charleston, W.Va.</td>
<td>100</td>
<td>Rochester, N.Y.</td>
<td>100</td>
</tr>
<tr>
<td>Columbus, Ohio</td>
<td>100</td>
<td>Saginaw</td>
<td>100</td>
</tr>
<tr>
<td>Elkhart</td>
<td>100</td>
<td>San Diego</td>
<td>100</td>
</tr>
<tr>
<td>Erie</td>
<td>100</td>
<td>San Francisco</td>
<td>75</td>
</tr>
<tr>
<td>Flint</td>
<td>100</td>
<td>Sarasota</td>
<td>100</td>
</tr>
<tr>
<td>Ft. Wayne</td>
<td>100</td>
<td>Saulte Ste Marie</td>
<td>100</td>
</tr>
<tr>
<td>Grand Rapids</td>
<td>100</td>
<td>Seattle</td>
<td>100</td>
</tr>
<tr>
<td>Green Bay</td>
<td>100</td>
<td>South Bend</td>
<td>100</td>
</tr>
<tr>
<td>Hartford</td>
<td>100</td>
<td>Stevens Point</td>
<td>100</td>
</tr>
<tr>
<td>Kalamazoo</td>
<td>100</td>
<td>Syracuse</td>
<td>100</td>
</tr>
<tr>
<td>Lansing</td>
<td>100</td>
<td>Tampa</td>
<td>75</td>
</tr>
<tr>
<td>Las Vegas</td>
<td>100</td>
<td>Wausau</td>
<td>100</td>
</tr>
<tr>
<td>Los Angeles</td>
<td>100</td>
<td>Toledo</td>
<td>100</td>
</tr>
<tr>
<td>Louisville</td>
<td>100</td>
<td>Traverse City</td>
<td>100</td>
</tr>
<tr>
<td>Madison</td>
<td>100</td>
<td>Washington</td>
<td>75</td>
</tr>
<tr>
<td>Marquette</td>
<td>100</td>
<td>West Palm Beach</td>
<td>100</td>
</tr>
<tr>
<td>Memphis</td>
<td>100</td>
<td>White Plains</td>
<td>100</td>
</tr>
<tr>
<td>Milwaukee</td>
<td>100</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Official Airline Guide

Admittedly, there were also monopoly/duopoly routes before 1978. But at that time, the framework of regulation was available to protect individual markets against loss of service or inequitable pricing. Since deregulation, the above-described communities have lost the protection of regulation without gaining the intensity of competition that had been promised.
IV. PRICING AND SERVICE COMPETITION UNDER DEREGULATION

A. THE VULNERABILITY OF THE NEW PRICE/SERVICE OPTIONS

In the original deregulation debate, advocates argued the need for new price/service options. For example:

The present system of regulation is seriously deficient. . . . [] It causes air fares to be considerably higher than they would be otherwise; it discourages service innovations; it denies consumers the range of price and service options which they would prefer. . . . \(^{17}\)

The concept of new price and service options envisioned that one level of amenities would be offered at one price, while a lesser level would be offered at a lower price. A Senate Committee concluded: "Air service can be made available to the American public at significantly lower prices. Increased competition is likely to bring about the provision of such service." \(^{18}\)

For the first few years of deregulation, this expectation was fulfilled. New entrant carriers did indeed offer lower fare service, with fewer or no frills. By 1987, however, most of the new low-fare entrants had dropped out of the picture.

In the free market, low-fare/low quality service turned out to lack competitive staying power. Deregulators had assumed that new carriers would establish a pricing niche below the fares the full-service lines could afford to charge. Thus, the CAB Staff Report on Regulatory Reform stated: "cost differences will permit new firms to price under existing airlines." \(^{19}\)

However, this overlooked the fact that the incumbent carriers would not have to base their responsive pricing on their average full costs. The relevant yardstick would usually be a very much lower marginal cost. The reason is as follows.

The cost of operating an existing flight is affected to only a limited degree by the precise passenger load on that flight. Most of the large cost elements (e.g., amortization of aircraft investment, maintenance of aircraft, crew pay, landing fees, and ground equipment) are incurred by the mere flying of the schedule itself and are virtually the same whether the flight is empty or full. The costs that do vary with the actual load (e.g., cost of ticketing, meals, and sales commissions) account for roughly 20% of the overall cost of operating the flight.

Therefore, if an incumbent carrier is faced with the loss of passengers to a competitor's lower fare, the expenses saved with the loss of that

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\(^{17}\) Snow, supra note 5, at 638.
\(^{19}\) CAB Staff Report, supra note 8, at 112 n.1.
traffic will be minimal. Stated differently, the marginal cost of retaining that traffic will be equally small. Even if the incumbent carrier finds it necessary to discount its normal fare by 40% in order to avoid the traffic loss, the remaining 60% of its normal revenue would substantially exceed the small marginal cost of keeping the seat occupied rather than empty.

Thus, even when the new entrant had a clearly lower cost structure, the incumbent carrier usually concluded that it would lose less by matching the lower fare (and getting at least partial revenue from an occupied seat) than by maintaining its normal fare (and flying an empty seat). This is not, as sometimes alleged, a matter of predatory pricing. Rather it is a case of choosing the less harmful of two alternatives.

Once the established carriers started matching the low fares, they then had the unbeatable combination of virtual price parity coupled with their normal amenity advantages. A typical advertising theme was: "And Delta gets you there with all this." The copy of the ad then stressed that low fares were available on Delta, along with "Wide-Ride comfort on most of our nonstopls between Newark and Atlanta," "Complimentary dining at mealtime," "Complimentary baggage checking," "Advance seat selection," "Free coffee and soft drinks on all flights," and "Free trips for Delta's Frequent Flyers."\(^{20}\)

Each of the service items mentioned above was of course absent on People Express Flights, at which this ad was directed. This type of responsive strategy blunted the marketing effectiveness of the low fare specialists. Their low fares depended upon very high load factors, and it became impossible to sustain adequate load factors when facing full-service competition at similar fares. For example, in the first quarter of 1986, People Express' load factor of 62% looked good by normal airline standards, but it was nine percentage points short of the break-even level required by its low fares.

As the low-fare specialists found their penetration of the leisure market limited by the fare-matching strategy of the incumbent carriers, they started to look beyond that market, and sought access to the business travel market as well. This made it necessary to abandon the no-frills concept, and thus to move to a higher cost level. That further diluted their marketing message, and reduced their ability to find a survivable, separate niche.

These comments apply not only to new entrant carriers (like People Express, but also to former charter carriers (like World). The latter ran into the same competitive response when they tried to apply their low fares to scheduled service. By 1987, several of the former charter operators were bankrupt, and the others had discontinued scheduled service.

\(^{20}\) N.Y. Times, July 26, 1985, at A5.
Incidentally, charters illustrate the paradox that regulation can, in this industry, actually preserve some aspects of competition that the free market cannot. Under regulation, the CAB permitted scheduled carriers to discount their fares enough to be competitive—but did not let the discounts get deep enough to destroy the pricing niche of the charter carriers. Deregulation, on the other hand, has had no such floor to limit the depth of scheduled discounts. Without some regulated "spread" between charter fares and scheduled fares, charter operators could not sell the more restricted nature of their service, and could not survive in any significant degree.

Alfred Kahn has referred to the failure rate off new airlines as "frightening." Their inability thus far to find a sustainable low-fare niche bodes ill for their future. New entrants had their most favorable "window of opportunity" in the early years of deregulation—before the existing carriers brought labor costs into line, expanded their route networks, or consummated their various mergers. Conditions for new firms will never again be as favorable.

B. FAILURE OF THE "CONTESTABLE MARKET" THEORY

Deregulators promised that no route would suffer for lack of active competition. The "contestable market" theory held that there were no effective barriers to entry, and therefore there would always be a sufficient threat of new competition to keep incumbent carriers from abusing a monopoly position. DOT expressed the principle as follows:

The threat of potential competition will police carrier behavior and provide the needed incentive for carriers in existing markets to keep prices at a level low enough to forestall the entry of competitors. . . . Potential competition is a vitally important force in producing desirable market results, i.e., in assuring that firms are diligent in providing the type of service and price/quality options that the public desires.21

The theory that the mere threat of new competition would police the market could work only if such threat were perceived by incumbents as real and imminent. This has not been the case. Those who originally advanced this theory appear to have been influenced by several of the misconceptions already noted above. For example, they assumed that a new entrant would find its small size no competitive handicap against a larger, established incumbent, because of the already-noted belief that there was no economy of scale. It was also implicitly assumed that the new entrant, in lowering fares on the route, would have a sufficient period of price advantage so as to gain a foothold in the market. However, deregulation experience has shown that incumbents will normally match the

lower fare immediately. Thereupon, the new carrier would have the difficult task of trying to achieve a viable market share against an equally-priced incumbent that would have such market advantages as established public identity, working relationships with local travel agents, and local residents enrolled in its frequent flyer club.

The combination of these factors has rendered the threat of significant new entrant competition more theoretical than real, and thus has invalidated the theory that market contestability would police those routes lacking competition. Moreover, the deregulators did not foresee the enormous development of hubs, and the special inhibition which hub strength would impose against new entrant competition. This is especially important because the main routes that have developed into single-carrier monopolies (and which therefore would be most affected by market "contestability") are the routes into powerful hubs. Yet it is on these routes that the market position of the incumbent carriers is most strongly entrenched against a would-be new entrant. With its myriad of connections, the hub incumbent can fill many (or most) of its seats with passengers traveling through and beyond the hub. This advantage cannot be matched by a new entrant seeking to challenge the incumbent on just the local route terminating in the hub.

C. THE DISPARITIES OF Deregulated Pricing

Because the threat of potential competition has not had the effect promised, there has been widely disparate pricing between different city-pairs. Dr. Kahn has referred to "outrageous, or seemingly outrageous, examples of geographic price discrimination."22

Some city-pairs have enjoyed tremendous bargains, while others have had very steep price inflation. Pricing has been most favorable in city-pairs with the most competitors, particularly if one or more of the competitors has an incentive to offer low fares on the route. In such cases, other carriers on the route have been forced to match the price-cutting carrier. Because these lower fares are often below the full average cost of many carriers, they have found it necessary to compensate by raising fares substantially in less competitive markets.

Figure 6 illustrates the resulting disparities. In a cross-section sample, there were some routes where fares had actually declined between 1978 and 1984, while, at the other extreme, there were markets where fares had increased by over 180%. (All of the routes showing declines were served at the time by People Express.)

In May 1987, that analysis was updated for the more extreme cases, to see whether they continued to show such wide disparity (Figure 7).

22. Kahn Speech, supra note 13, at 5.
**Figure 6**

**Variation in Fare Increase in Different Markets, 1978-1984**

<table>
<thead>
<tr>
<th>Percentage Fare Increase</th>
<th>Number of Markets</th>
<th>Percent of Markets</th>
</tr>
</thead>
<tbody>
<tr>
<td>-20% to --1%</td>
<td>5</td>
<td>7%</td>
</tr>
<tr>
<td>0 to +39%</td>
<td>13</td>
<td>19%</td>
</tr>
<tr>
<td>+40% to +79%</td>
<td>9</td>
<td>13%</td>
</tr>
<tr>
<td>+80% to +119%</td>
<td>17</td>
<td>24%</td>
</tr>
<tr>
<td>+120% to +139%</td>
<td>9</td>
<td>13%</td>
</tr>
<tr>
<td>+140% to +179%</td>
<td>9</td>
<td>13%</td>
</tr>
<tr>
<td>+180% and over</td>
<td>8</td>
<td>11%</td>
</tr>
<tr>
<td>Total</td>
<td>70</td>
<td>100%</td>
</tr>
</tbody>
</table>

*Source: BRENNER, LEET, SCHOTT, AIRLINE Deregulation (1985) (study published by ENO Foundation). Seventy-market sample represented a cross-section of different segment lengths and traffic volumes.*

The original People Express markets had by then been taken over by Continental, and were no longer quite the same bargains as previously. However, they still maintained a considerable disparity vis-a-vis the high-increase markets. Between 1978 and May 1987, the price inflation for the low-increase sample averaged 93%, which was no longer favorable relative to the Consumer Price Index, but which nevertheless was less inflated than the high-increase sample, where the cumulative escalation now averaged over 200%.

The price differential on less competitive routes is further demonstrated by comparing the fares charged by Continental between Newark-Detroit versus Newark-Chicago. In January 1988, that carrier charged $210 as its one-way fare from Newark to Detroit, but charged either $90 or $135 (depending on departure time) from Newark to Chicago. The Newark-Chicago distance is 41% longer than that of Newark-Detroit—and yet the fare for the longer trip was 44%-53% less in absolute dollars. Presumably, this sharp disparity reflected the greater competition Continental faced on the Chicago route compared with the Detroit route. (Incidentally, the $210 Newark-Detroit fare represents an inflation of 200% over the 1978 fare on the same route.)

The lack of cost relationship in deregulated pricing is further indicated by the many other examples of short trips costing more (in absolute dollar amount) than much longer ones. A May 1987 sampling of Detroit fares indicated such disparities as the following:

- Northwest had an unrestricted one-way fare of $205 from Detroit to Los Angeles (1,988 miles), but charged $255 for the 771-mile trip to Ft. Smith, Ark.—thus charging 24% more for traveling 61% fewer miles.
- American charged $255 for the trip to Dallas (1,002 miles), but $215 to
Figure 7
1987 Updating of Fare Changes for Specified Markets

<table>
<thead>
<tr>
<th>City-Pair Markets</th>
<th>Fare Change 1978 to 1984</th>
<th>Fare Change 1978 to 1987</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A. Markets with Lowest Increases to 1984</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New York-Norfolk</td>
<td>-19%</td>
<td>+123%</td>
</tr>
<tr>
<td>New York-Portland (Me.)</td>
<td>-17</td>
<td>+85</td>
</tr>
<tr>
<td>New York-Columbus (Ohio)</td>
<td>-8</td>
<td>+85</td>
</tr>
<tr>
<td>New York-West Palm Beach</td>
<td>-8</td>
<td>+57</td>
</tr>
<tr>
<td>Syracuse-Norfolk</td>
<td>-2</td>
<td>+97</td>
</tr>
<tr>
<td>New York-Syracuse</td>
<td>0</td>
<td>+111</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td>-9%</td>
<td>+93%</td>
</tr>
<tr>
<td><strong>B. Markets with Largest Increases to 1984</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>St. Louis-Chattanooga</td>
<td>+236%</td>
<td>+207%</td>
</tr>
<tr>
<td>St. Louis-Cincinnati</td>
<td>+231</td>
<td>+329</td>
</tr>
<tr>
<td>Nashville-Atlanta</td>
<td>+198</td>
<td>+285</td>
</tr>
<tr>
<td>Salt Lake City-Billings</td>
<td>+195</td>
<td>+249</td>
</tr>
<tr>
<td>Syracuse-Philadelphia</td>
<td>+183</td>
<td>+202</td>
</tr>
<tr>
<td>Syracuse-Atlanta</td>
<td>+183</td>
<td>+93</td>
</tr>
<tr>
<td>Columbus-Omaha</td>
<td>+181</td>
<td>+221</td>
</tr>
<tr>
<td>Nashville-Birmingham</td>
<td>+181</td>
<td>+78</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td>+198%</td>
<td>+208%</td>
</tr>
</tbody>
</table>

Note: Markets are among those sampled in Figure 6. The markets specified above in "lowest increase" category are those city-pairs which had no increase, or actual decrease, between 1978 and 1984. The markets in "largest increase" category are those which had an increase of 180% or more in that study. As in the analysis in Figure 6, the 1987 fares were obtained by telephone calls to the airlines’ reservations offices, requesting the lowest one-way coach fare available for travel during the following week.

Salt Lake City (1,489 miles), resulting in a 19% higher fare for a 33% shorter trip.
- TWA charged $195 for Detroit-Kansas City, but charged $10 more for the 39% shorter trip to St. Louis. In fact, TWA offered an even cheaper three-day advance purchase fare to Kansas City (not available to St. Louis), which made the longer trip $76 less expensive than the shorter one.

These same examples are also revealing in their widely varying rate of inflation vis-a-vis 1978 levels. Thus:
The fare from Detroit to St. Louis had increased 220%, while the fare to Los Angeles had increased only 12%. These variations depend not so much on the market size of the destination, but rather on the amount and nature of competition. Detroit-Los Angeles, with competition from just about all major carriers via their respective hubs, has favorable fares. The competition from Detroit to St. Louis is less intense, and the fare escalation on that route is substantially larger. In short, some parts of the public get bargains, while other passengers are subsidizing those bargains by the steep escalation in their fares.

These comments do not imply that carriers have been deliberately exploiting the less competitive routes for their own enrichment. The fact is that no airline has enjoyed really high profits, by the normal standards of industry at large. Most airlines have had limited profits, or none at all. The fact that fares have been higher on less competitive routes appears to reflect primarily a balancing against depressed fares elsewhere—a balancing needed for financial survival.

D. OVERALL CHANGE IN AVERAGE FARES

The widespread impression is that deregulation has led to sharply reduced fares. That impression is incorrect. The preceding section has indicated the wide pricing disparities between individual markets. When the industry-wide average fare level is considered—reflecting the totality of travel on all types of routes—deregulated pricing has not shown major improvement compared with prior trends.

In constant dollars (i.e., adjusted for inflation), the industry’s yield per passenger mile declined by an average of 2.6% per year in the eight deregulated years between 1978 and 1986. This was not materially different than the average decline of 2.2% per year over the same period prior to deregulation (See Figure 8). Moreover, even this small difference overstates the effect of deregulation for several reasons:

- Deregulated scheduling involves greater mileage on many trips (because of the circuitous routing through hubs). The need to travel more miles to the same destination would statistically make the average fare-per-mile look lower, even if the fares themselves had not changed.
### Figure 8

Yield Change in Eight-Year Periods Before and After Deregulation

<table>
<thead>
<tr>
<th>Year</th>
<th>Yield (in Current Dollars)</th>
<th>Yield (in Constant 1967 Dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>A. Eight Years Before Deregulation</td>
</tr>
<tr>
<td>1970</td>
<td>5.8¢</td>
<td>5.0¢</td>
</tr>
<tr>
<td>1978</td>
<td>8.3</td>
<td>4.2</td>
</tr>
<tr>
<td></td>
<td>Average annual change</td>
<td>-2.2%</td>
</tr>
<tr>
<td>1978</td>
<td>8.3¢</td>
<td>4.2¢</td>
</tr>
<tr>
<td>1986</td>
<td>11.0</td>
<td>3.4</td>
</tr>
<tr>
<td></td>
<td>Average annual change</td>
<td>-2.6%</td>
</tr>
</tbody>
</table>

* Source: Calculated from data of CAB and ATA.

- The 1986 data does not yet reflect the absence of People Express, the carrier which had the most widespread impact in the direction of reduced industry yields.
- The post-1978 yields lacked staying power, because they were not adequately related to costs and caused heavy losses or inadequate earnings. Thus, Alfred Kahn wrote in October 1986: "There is a strong likelihood that the deep, intense price competition will abate. Indeed it is not sustainable because the industry as a whole is losing money."\(^{23}\)

In view of these qualifications to the deregulated yields, the fact that they show so little improvement over the trends of previous years becomes all the more significant.

### V. EXCESS CAPACITY AND DETERIORATING INDUSTRY ECONOMIC HEALTH

#### A. EFFECT OF DeregULATION ON TRAFFIC GENERATION

Associated with the impression that deregulation has sharply reduced fares is the impression that it has stimulated a large amount of new travel. This impression also is misleading.

Figure 9 indicates the increases in passenger miles before and since deregulation. For the eight years following 1978, traffic increased by an average of 6.2% per year. As indicated in the same table, this was actually less than the growth rate under regulation, which averaged 7.0% for the eight years leading to 1978.

---

Figure 9
Traffic Growth in Eight-Year Periods Before and After Deregulation

<table>
<thead>
<tr>
<th>Year</th>
<th>Passenger Miles (Billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>132</td>
</tr>
<tr>
<td>1978</td>
<td>227</td>
</tr>
<tr>
<td>1986</td>
<td>366</td>
</tr>
<tr>
<td>1970-1978 average annual change (percentage)</td>
<td>+7.0%</td>
</tr>
<tr>
<td>1978-1986 average annual change (percentage)</td>
<td>+6.2%</td>
</tr>
</tbody>
</table>

Source: Calculated from data of CAB and ATA.

The lack of dramatic market stimulation is partly the result of the manner in which deregulated fares have been discounted. The air travel market consists of several distinct segments, each with a different price elasticity. For maximum traffic stimulation, any discount should be pinpointed in its application to encourage trips that would not otherwise have been made.

However, under the pricing pressures of deregulation, many discounts have been available with little or no restriction. In 1986, some 90% of all passengers traveled on a discount. With such wholesale availability of discounts, large numbers of discounted passengers come from the less discretionary portions of the market and would have traveled regardless of the discount. Hence, the increase under deregulation in passenger miles, represented in Figure 9, fails to show the traffic response which massive price-discounting activity would normally be expected to generate.

B. EFFECT OF DEREGULATION ON AIRLINE ECONOMICS

The eight years of deregulation comprise the worst financial period in airline history. The cumulative industry operations in those eight years generated a loss of over $7 billion, when interest payments are included with operating expenses. Figure 10 compares the financial results of these eight years with several eight-year periods before deregulation. The deregulation era is the first time that the industry as a whole has recorded a cumulative loss over an eight-year period.
Airline Deregulation

Figure 10
Airline Industry Financial Results for Specified Eight-Year Periods
Before and After Deregulation

<table>
<thead>
<tr>
<th>Period</th>
<th>Operating Profit After Interest (Millions)</th>
<th>Profit as Percentage of Gross Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Before Deregulation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1939-1946</td>
<td>$155</td>
<td>+ 7.0%</td>
</tr>
<tr>
<td>1947-1954</td>
<td>514</td>
<td>+ 10.0%</td>
</tr>
<tr>
<td>1955-1962</td>
<td>459</td>
<td>+ 2.3%</td>
</tr>
<tr>
<td>1963-1970</td>
<td>1,423</td>
<td>+ 4.7%</td>
</tr>
<tr>
<td>1971-1978</td>
<td>2,235</td>
<td>+ 1.8%</td>
</tr>
<tr>
<td>B. After Deregulation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1979-1986</td>
<td>(7,068)</td>
<td>(2.3)%</td>
</tr>
</tbody>
</table>

Source: Derived from data from CAB and ATA.

Initially, the deregulators blamed industry losses on factors other than deregulation—particularly the 1979 jump in fuel prices and the 1980-1982 recession. However, by 1986 those external factors were gone. The nation’s economy was favorable, and fuel prices had tumbled sharply. Still the industry’s overall financial results were weak. In 1986, industry operating profits remained inadequate to cover interest payments (Figure 11).

The principal cause of the poor financial results has been the tendency of airlines to engage in destructive competition in the absence of regulation—a tendency evident particularly in excess capacity and fare wars. In both scheduling and pricing, competitive pressures lead airlines to excessive reliance on marginal costs. Marginal cost decisions usually look rational to the individual firms making them. However, if unchecked, they build into a cumulative result that is uneconomic for the industry as a whole. By failing to cover fixed costs, marginal cost reliance jeopardizes the industry’s long term viability.

C. Competitive Pressure for Over-Capacity

The pressure to over-schedule on the basis of marginal cost is inherent in air transport competition. This is because air transport is unique in the way that merely increasing the level of output enhances the competitive appeal of a firm. In this industry, increasing output means flying more schedules, and each schedule adds a distinctive new qualitative dimension to an airline’s product catalogue. This dimension may be a new de-
Figure 11
Airline Industry Annual Operating Profit, After Interest Payments, Before and After Deregulation

<table>
<thead>
<tr>
<th>Year</th>
<th>Profit/Loss (Millions)</th>
<th>Profit Margin</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Before Deregulation</td>
<td></td>
</tr>
<tr>
<td>1971</td>
<td>$ (3)</td>
<td>(0.0)%</td>
</tr>
<tr>
<td>1972</td>
<td>277</td>
<td>2.5</td>
</tr>
<tr>
<td>1973</td>
<td>217</td>
<td>1.8</td>
</tr>
<tr>
<td>1974</td>
<td>306</td>
<td>2.1</td>
</tr>
<tr>
<td>1975</td>
<td>(274)</td>
<td>(1.8)</td>
</tr>
<tr>
<td>1976</td>
<td>351</td>
<td>2.0</td>
</tr>
<tr>
<td>1977</td>
<td>535</td>
<td>2.7</td>
</tr>
<tr>
<td>1978</td>
<td>826</td>
<td>3.6</td>
</tr>
<tr>
<td>Total</td>
<td>2,235</td>
<td>1.8%</td>
</tr>
<tr>
<td></td>
<td>After Deregulation</td>
<td></td>
</tr>
<tr>
<td>1979</td>
<td>$ (420)</td>
<td>(1.5)%</td>
</tr>
<tr>
<td>1980</td>
<td>(1,186)</td>
<td>(3.5)</td>
</tr>
<tr>
<td>1981</td>
<td>(1,717)</td>
<td>(4.7)</td>
</tr>
<tr>
<td>1982</td>
<td>(2,170)</td>
<td>(6.0)</td>
</tr>
<tr>
<td>1983</td>
<td>(1,147)</td>
<td>(2.9)</td>
</tr>
<tr>
<td>1984</td>
<td>520</td>
<td>1.2</td>
</tr>
<tr>
<td>1985</td>
<td>(181)</td>
<td>(0.4)</td>
</tr>
<tr>
<td>1986*</td>
<td>(767)</td>
<td>(1.6)</td>
</tr>
<tr>
<td>Total</td>
<td>(7,068)</td>
<td>(2.3)%</td>
</tr>
</tbody>
</table>

Source: Derived from data of CAB and ATA.

* For comparability with earlier years, Federal Express data are excluded from 1986.

Parture time, a new choice of airports in a metropolitan area, or a new nonstop to replace connecting service.

This competitive pressure to increase output does not exist in most other industries. The consumer of cameras, autos, or TV sets, will not even be aware of the fact that one particular manufacturer has changed its production rate, and will not perceive any change in the appeal of that specific model because of such output change. Therefore, in other fields, the individual firm can base its production plans on its anticipated sales level, without an incentive to go beyond such level for competitive impact.

In contrast, the consumer of air transportation will find the frequency of schedules one of the most important aspects of convenience. The airline with ten daily flights in a market will have twice as much chance of satisfying a particular departure time desire as the airline with only five.
This creates pressure to add schedules for their competitive value, and often without regard to whether or not there is a quantitative need for the added seats.

To the individual airline considering a new schedule, the financial evaluation will usually rely much more heavily on the anticipated diversion of traffic from other carriers, than on anticipated new passengers brought into the market. This creates a built-in dichotomy between the micro-economics and the macro-economics of the scheduling decision. The carrier adding the flight can credit the diverted traffic as "new revenue" with which to offset the incremental cost of the flying. But diverted traffic, merely shifted between carriers, is obviously not new revenue from a macro industry standpoint. Therefore, the very same schedule that appears economically justified to the line adding it will often be just a step toward excess capacity for the market as a whole.

The competitive pressure for excess capacity was recognized by the deregulation advocates. Alfred Kahn observed in his 1971 text: "The airline with the most flights between any two points is the one to which customers will turn first in making their reservations." He then went on to state:

The result, where competition is strong and particularly in markets where new entry threatens, is a cumulative tendency to excess capacity, with each company vying with the other by increasing the number of daily flights on its schedule.... But where scheduling is purely duplicative and the traffic actually generated could be carried on fewer flights, the competition has produced only waste.24

The tendency to over-schedule has been perennial in airline operations. For much of the pre-1978 experience, that tendency was obscured by periods of explosive growth in the 1950s and the 1960s, when sustained, double-digit traffic increases made it almost impossible to add seats too quickly. Significantly, decent profit-margins have been concentrated in periods when traffic was growing at annual rates of 15% or more (Figure 12).

Obviously traffic cannot be expected to sustain growth rates of that level endlessly. In years when traffic has expanded more moderately (i.e., the seventeen years when growth was under 10%), the after-interest profit margins have averaged close to zero—a reflection of the difficulty of controlling capacity when traffic is not actually booming.

Dr. Kahn and the other deregulators were fully aware of the airlines' competitive tendency to over-schedule, and deplored the waste of the resulting excess capacity. But they argued that regulation itself had been responsible for this, by denying carriers the freedom to compete in the

alternative sphere of pricing. Thus Dr. Kahn stated: "[T]he answer to the fear of excessive capacity and low load factors, I am convinced, is to reverse the process that produces this kind of wasteful, cost-inflating service competition, by opening the door to price competition."25

This theory was based on a misconception of how the airline free market would function. The deregulators contemplated that, with pricing freedom, a carrier would be able to opt out of schedule competition by simply offering a lower fare for a less convenient schedule pattern. Thus it was argued that "in the absence of entry and price regulation, a new firm with a limited schedule could compete with incumbent carriers on the basis of a lower price."26

However, this theory failed the test of the marketplace. Under deregulation, carriers with more frequent service have not passively accepted the penalty of a noncompetitive fare. Instead, they normally have matched a competitor's lower fare while retaining schedule superiority. Therefore, scheduling rivalry—characterized by the deregulators as "wasteful" and "costly"—has continued undiminished under deregulation. A 1987 article describing American Airlines' expansion plans referred to "the prime need for service frequency in the competitive U.S. industry."27

Three years after the start of deregulation, one of its principal sponsors, Michael Levine, commented: "Excess capacity is the single most important threat in existence to the financial health of the airline industry."28 Shortly thereafter, Business Week quoted an airline president as saying: "As empty as we’re flying, there’s an insane probability of

26. CAB STAFF REPORT, supra note 8, at 116, 117.
sharp increased capacity." In early 1987, the First Boston Corporation commented: "Airlines have a chronic excess capacity problem." The same source also expressed concern about "the large capacity additions that could outpace demand . . . in 1988."

Deregulation not only has failed to achieve the promised goal of eliminating excess capacity; it has actually increased the pressures for such excess. It has done so because of the massive emphasis on hub-and-spoke scheduling. Each additional spoke, and each additional schedule frequency, adds geometrically to the permutations of connection possibilities in a hub. From a marketing standpoint, this pressure is virtually open-ended.

When past scheduling focused primarily on direct, point-to-point city-pair service, the risk of moving into an over-capacity situation was more visible. Within a given city-pair, it was possible to measure the relationship of one more incremental schedule relative to the traffic volume of that city-pair and the totality of capacity already on the route. The possibility of over-capacity could be measured (and better guarded against) within a discrete and self-contained geographic route boundary. In contrast, when schedule additions come mainly by adding new spokes to a carrier's hub (or opening entirely new hubs) a developing tendency toward excess capacity is much more geographically diffused, less directly measurable, and more difficult to guard against.

Other countries have long recognized the tendency for competition to create over-scheduling, and have attached capacity limitations to their bilateral agreements on air traffic rights. For a brief period in the early 1970s, the U.S. government also recognized the pressure for over-scheduling, and encouraged airlines to work out inter-carrier agreements for mutual, reciprocal schedule reductions. A few years later, the deregulation statute moved in the diametrically opposite direction, not only throwing open the entire route map to unlimited competition, but specifi-
cally outlawing any future capacity restraint agreements.34

The preceding discussion regarding excess capacity may seem inconsistent with the fact that a higher percentage of seats is occupied now than before 1978. Deregulators sometimes point to this rise in load factor as a sign of improved efficiency.

However, load factor by itself has become almost meaningless in a marketplace where excess seats can be filled by virtually giving them away in price wars. (During one transcontinental price war, the president of one low-cost carrier indicated that he would lose money even if every seat were occupied, and that he would need a load factor of 139% just to break even.)35

In this environment, an index of sound capacity management cannot be found in load factor alone—but rather in the spread between actual vs. break-even load factor. The industry’s actual load factor since deregulation began has averaged 60%, which is six percentage points above the 54% average for 1971-1978. However, the break-even meanwhile has jumped by nine percentage points—from a previous 53% to a deregulated 62%. Thus, actual load factor slipped from being one percentage point on the right side of break-even to being two points on the wrong side. With this industry’s highly leveraged finances, that negative swing of three percentage points has been enough to create the losses noted above.

D. COMPETITIVE PRESSURE FOR UNECONOMIC PRICING

Throughout the period of deregulation, fare wars have repeatedly depressed airline earnings. As a result, the trend of average yields has failed to keep up with the industry’s unit cost trend (Figure 13.) This accounts for the sharp increase in break-even load factors noted above.

The persistence of uneconomic pricing over a span of eight years precludes the presumption that such pricing merely reflects inept management. Rather it stems from inherent characteristics of the airline product and its marketing.

Airline seats are sold individually, but are produced in indivisible plane-load lots, generally of 100 or more seats. Any seats unsold at departure time are instantly perishable. In addition, as discussed earlier, the “marginal cost” of filling an otherwise empty seat is minimal (approximately 20% of full average cost).

With this combination of conditions, there is always the strong temptation to sharply discount the full fare in order to fill more seats. This

Figure 13
Cumulative Changes in Average Seat-Mile Cost and Average Yield
Since 1978

<table>
<thead>
<tr>
<th>Year</th>
<th>Seat-Mile Cost</th>
<th>Passenger-Mile Yield</th>
<th>Yield vs. Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>1979</td>
<td>14.8%</td>
<td>4.8%</td>
<td>-10.0%</td>
</tr>
<tr>
<td>1980</td>
<td>38.1</td>
<td>32.5</td>
<td>-5.6</td>
</tr>
<tr>
<td>1981</td>
<td>55.2</td>
<td>48.2</td>
<td>-7.0</td>
</tr>
<tr>
<td>1982</td>
<td>50.3</td>
<td>42.2</td>
<td>-8.1</td>
</tr>
<tr>
<td>1983</td>
<td>47.6</td>
<td>39.8</td>
<td>-7.8</td>
</tr>
<tr>
<td>1984</td>
<td>43.3</td>
<td>45.8</td>
<td>+2.5</td>
</tr>
<tr>
<td>1985</td>
<td>45.9</td>
<td>41.0</td>
<td>-4.9</td>
</tr>
<tr>
<td>1986</td>
<td>34.9</td>
<td>31.3</td>
<td>-3.6</td>
</tr>
</tbody>
</table>

Note: Seat-mile costs are calculated on the basis of CAB methodology in which non-passenger traffic is assumed to operate at break-even. Therefore, the cost of handling non-passenger traffic is assumed to equal its revenue.
Source: Calculated from data of CAB, DOT, and ATA.

would be economically sound (from both a micro and a macro standpoint) if the passengers filling those extra seats represent newly generated traffic, which would not be traveling in the absence of the discounts. The revenue from such passengers would be clearly incremental, and even the discounted fares could more than cover the small incremental cost of filling empty seats.

The problem is that, once a discount is offered, it is difficult to limit its use to newly-generated passengers. To the extent that it is used by passengers who otherwise would have been paying full fare, the discounted fare becomes a source of revenue dilution, rather than revenue generation.

Airline promotional pricing has always faced the dilemma of trying to maximize the generative effect of new discount fares while minimizing the diversion of existing market. With regulation, the CAB forced a degree of discipline into this process by requiring that proposals for new discounts be accompanied by a written justification which would include documented analysis of the prospects for new traffic generation.

With deregulation, that discipline has been lost. In 1986, fully 90% of the traffic of the major airlines traveled on some form of discount. Obviously, so high a percentage of the total traffic could not possibly all be "generated" by the discount. A large amount of fare downgrading necessarily must exist by passengers who would otherwise have been traveling at full fare.

In the free market, there are several factors that encourage uneconomical levels of airline discounting. The principal one is that the same route can have differing financial implications to different carriers. Some carriers are able to view a specific route in strictly by-product terms and therefore are able to undercut the fully-costed pricing needed by other carriers on that same route. A prime example is a city-pair served nonstop by some carriers, but served only by one-stop or connecting flights by others. The latter carriers would not normally expect to carry any significant number of passengers in this market against the competition of the nonstop lines. If they offer a discount on this route, they need not worry about the possible downgrading of existing traffic—since such traffic would otherwise be flying on some other line. Thus, any traffic they divert with this discount is incremental to their flights, with virtually no downside risk of yield erosion. This tends to remove the balancing of risk-versus-benefit that should be part of prudent, economical business decision-making.

The vast proliferation of hub-and-spoke scheduling has given great impetus to precisely this by-product approach to pricing. Most of the major carriers now serve just about all significant medium-haul and long-haul city-pair markets, via their mid-continent hubs. Each hub provides connecting linkage for hundreds of city-pair combinations, and for most of those combinations the carrier does not have specific investment committed. For example, though TWA can serve the Boston-Salt Lake City market via a St. Louis connection, it has no aircraft, ground facility, or sales promotion investment specifically tied to that city-pair. The TWA planes that can connect passengers for a Boston-Salt Lake City trip are part of the St. Louis hub complex and thus are also available for hundreds of other city-pairs. In this situation, it has become increasingly common to discount on the basis of by-product costing—which, in the aggregate, leads to insufficient overall average yield.

VI. SERVICE LEVELS UNDER DEREGULATION

A. Massive Disruption of Route Structure

Deregulation removed the traditional "public utility" obligation which required carriers to provide adequate service throughout their authorized route systems. Carriers could accept that obligation when they had the ability to cross-subsidize thin traffic routes with above-average profits from strong ones. But that in turn required that the profits on the strong routes be preserved by limiting competition on them.

Once the stronger routes were thrown open to "free entry," it became necessary simultaneously to authorize "free exit" from the weak routes. The deregulators sought to reassure communities concerned
about possible loss of service by denying that cross-subsidy had been a significant factor. Thus it was claimed that: "There is not any theoretical or empirical evidence showing the existence of cross-subsidy for the trunkline carriers."37

Relying on that belief, the deregulators further asserted that, even with free entry and exist, there would be only minor changes from previous route structures. The Kennedy Subcommittee went so far as to predict that trunk carriers might seek to discontinue service over routes "that at the very most account for one-half of one percent of revenue passenger-miles now flown."38

Figure 14 shows the wide chasm between such assurances and the eventual reality. By 1983, the original certificated lines had, on average, dropped 58% of the nonstop routes they had respectively served in 1978.

Figure 14
Number of Routes Served Nonstop by Carriers,
July 1978 and July 1983

<table>
<thead>
<tr>
<th>Carrier</th>
<th>Nonstop Markets Served 1978</th>
<th>Markets Dropped by 1983</th>
<th>Percent Dropped</th>
</tr>
</thead>
<tbody>
<tr>
<td>American</td>
<td>378</td>
<td>259</td>
<td>69%</td>
</tr>
<tr>
<td>Braniff</td>
<td>205</td>
<td>*</td>
<td>*</td>
</tr>
<tr>
<td>Continental</td>
<td>288</td>
<td>206</td>
<td>72%</td>
</tr>
<tr>
<td>Delta</td>
<td>669</td>
<td>339</td>
<td>51%</td>
</tr>
<tr>
<td>Eastern</td>
<td>565</td>
<td>304</td>
<td>54%</td>
</tr>
<tr>
<td>Frontier</td>
<td>519</td>
<td>416</td>
<td>80%</td>
</tr>
<tr>
<td>Northwest</td>
<td>238</td>
<td>84</td>
<td>35%</td>
</tr>
<tr>
<td>Ozark</td>
<td>254</td>
<td>174</td>
<td>69%</td>
</tr>
<tr>
<td>Pan Am</td>
<td>176</td>
<td>131</td>
<td>74%</td>
</tr>
<tr>
<td>Piedmont</td>
<td>382</td>
<td>218</td>
<td>57%</td>
</tr>
<tr>
<td>Republic</td>
<td>658</td>
<td>365</td>
<td>55%</td>
</tr>
<tr>
<td>TWA</td>
<td>236</td>
<td>113</td>
<td>48%</td>
</tr>
<tr>
<td>United</td>
<td>642</td>
<td>408</td>
<td>64%</td>
</tr>
<tr>
<td>US Air</td>
<td>448</td>
<td>179</td>
<td>40%</td>
</tr>
<tr>
<td>Western</td>
<td>174</td>
<td>90</td>
<td>52%</td>
</tr>
<tr>
<td>Total</td>
<td>5,832</td>
<td>3,286</td>
<td>58%</td>
</tr>
</tbody>
</table>

* Bankrupt, and not operating as of July 1983

Note: In this same period, these carriers collectively added 3,514 new nonstop routes which they respectively had not operated in 1978.


37. Snow, supra note 5, at 661.
38. SUMMARY REPORT, supra note 18, at 613.
Here again, the deregulators had looked at factual information, but had applied an incorrect interpretation to it. They noted that, prior to 1978, carriers had rarely sought CAB approval to abandon routes. This was interpreted as indicating that very few routes were actually moneyslosers: "[P]resumably most alleged 'losing' markets are in fact self-supporting and would not be abandoned if regulation were terminated." 39

This theory failed to recognize that many routes were unprofitable (in failing to cover fully allocated cost) and yet more than covered their own direct, out-of-pocket costs. While not covering the full amount of overhead reasonably allocated to them, these routes did make a partial contribution to overhead. They needed cross-subsidy, since other routes had to pick up their shortfall in overhead coverage. Yet carriers were better off serving these routes than dropping them, since their elimination would mean losing even that partial contribution.

It was in the carriers' interest to continue serving such routes as long as the regulated route structure limited the other options for deploying the aircraft. Operating within a defined route franchise, the carriers' choice at that time was either to continue serving these routes or simply to ground the aircraft. Some contribution toward overhead was preferable to zero contribution from an idle plane.

That situation totally changed once all routes were thrown open to free entry. At that point, any route that had been providing only a partial contribution to overhead became a candidate for abandonment, if the carrier could find some other route which offered a prospect for somewhat greater contribution. Hence the massive turnover of routes indicated in Figure 14.

This substantial change of the route network has had a widely varying impact on communities of different size. A disproportionate share of the schedule increases since 1978 have gone to the hubs located in large and medium sized cities, whereas the smallest communities (designated by the FAA as "nonhubs") have experienced a slight decline in departure and greater declines in seat capacity. The share of the country's weekly flight departures scheduled at large and medium hubs increased from 66% in June 1978 to 74% in June 1987. (See Figure 15.) Meanwhile, the nonhub departures declined from 23% of the national total to 16%. In this same period, the total domestic seat capacity of scheduled flights increased by 55%, but the seat capacity at nonhub airports declined by 17% (Figure 15). This decline in seat capacity has resulted from downgrading at many of the smaller communities from jet service to commuter airline turboprop service, and this has meant a qualitative reduction of comfort as well as the quantitative reduction of seats.

Figure 15
Change in Airline Service, June 1987 vs. June 1978, by Airport Size Category

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Large hub</td>
<td>63,484</td>
<td>103,063</td>
<td>+62%</td>
<td>50%</td>
<td>57%</td>
</tr>
<tr>
<td>Medium hub</td>
<td>19,731</td>
<td>30,712</td>
<td>+56</td>
<td>16</td>
<td>17</td>
</tr>
<tr>
<td>Small hub</td>
<td>13,256</td>
<td>18,806</td>
<td>+42</td>
<td>11</td>
<td>10</td>
</tr>
<tr>
<td>Non-hub</td>
<td>29,543</td>
<td>29,271</td>
<td>(1)</td>
<td>23</td>
<td>16</td>
</tr>
<tr>
<td>Total</td>
<td>126,014</td>
<td>181,852</td>
<td>+44%</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Large hub</td>
<td>7,104</td>
<td>12,132</td>
<td>+71%</td>
<td>63%</td>
<td>69%</td>
</tr>
<tr>
<td>Medium hub</td>
<td>1,953</td>
<td>3,031</td>
<td>+55</td>
<td>17</td>
<td>17</td>
</tr>
<tr>
<td>Small hub</td>
<td>1,112</td>
<td>1,405</td>
<td>+26</td>
<td>10</td>
<td>8</td>
</tr>
<tr>
<td>Non-hub</td>
<td>1,175</td>
<td>971</td>
<td>(17)</td>
<td>10</td>
<td>6</td>
</tr>
<tr>
<td>Total</td>
<td>11,345</td>
<td>17,539</td>
<td>+55%</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Unpublished analysis by Department of Transportation, obtained by phone, July 1987.

For many of the smaller communities, the loss of jet service has been partly compensated by the availability of a wider array of destinations offered via hub connections. In the past, jet service at small communities was often of a token nature, with few destinations and limited choices of departure times. In such cases, service may actually have improved with the substitution of a rounded pattern of commuter flights to a hub, where connections could be obtained to destinations throughout the country. (This comment relates only to the availability of schedules; it does not relate to the pricing of such service. The wide disparity of deregulated fares has been previously noted, and small communities have generally experienced heavy escalation of their fares.)

In any event, the future continuity of service to the smallest communities remains uncertain. Thus far, the continuation of service to these communities has been partially immunized from the workings of the free market. Previously, certificated small communities were granted such immunity, through subsidy and service “lock-in” provisions which were supposed to be temporary, with a 1988 expiration date. Those provisions have now been extended. If at any time these small communities

---

are left to the full, undiluted effects of deregulation, it is not clear how many will continue to receive air service.

Moreover, small community service will be impacted by the congestion and delays at the large hubs to which they are now linked. An increasing number of such hubs are likely to become subject to "slot" allocation. As that happens, carriers will be under economic pressure to maximize the profit potential of their limited slots. Without the obligation to continue operating on any route, the service from hubs to smaller communities is likely to suffer.

The important point is that the removal of the public utility obligation was based on a flawed theory that cross-subsidy did not exist and that removal of the statutory service obligation would not jeopardize continued service to small communities. In fact, the distribution of air service since deregulation has disproportionately favored the larger markets, and the future level and nature of service to small communities is vulnerable because of factors discussed above.

B. CONGESTION AND DELAY PROBLEMS

By 1987, the airlines were under considerable criticism regarding congestion and delays. At the country’s twenty-two busiest airports, delays increased 25% in 1986 over 1985. In the first three months of 1987, delays at those same airports increased by an additional 13%. It has been estimated that U.S. airlines incur an average of 2,000 hours of delay daily, and that the value of the time lost by passengers is equivalent to about $1 billion per year.

Congressional hearings were held in 1987 to consider, among other things, the need for legislation to require changes in scheduling practices to assure greater dependability. In the fall of 1987, the Department of Transportation adopted rules requiring carriers to disclose information concerning their on-time records in order to provide passengers with a basis for making comparative judgments on this aspect of service quality.

Beyond this, the carriers themselves devoted special effort to changes in scheduling and other practices to reduce delays. As a long term solution, the carriers and the FAA stressed the need for greater expenditures on airports and airways to increase the capacity for handling traffic expansion.

While there appeared to be some improvement after the peak summer season of 1987, this issue is likely to intensify again in the peak seasons of coming years.

41. Delayed Again, FREQUENT FLYER, June 1987, at 50.
43. Airline Economics Incorporated, supra note 36, at 54.
In the meantime, it is important to place the issue of congestion in a broader context. Given the lag in airport and airway improvement expenditures, part of this congestion was bound to happen with or without deregulation. As pointed out previously, the rate of passenger traffic growth under deregulation has not been greater than the rate prior to 1978. Therefore, the long term trend of traffic growth was itself on a collision course with a relatively static airport/airway capacity. However, certain changes associated with deregulation have intensified the congestion problem. One in particular is the quantum development of hub-and-spoke scheduling. A major hub necessarily requires a bunching of closely-spaced arrivals and departures in order to maximize the permutation of connections.

The very nature of a hub creates a multiplier incentive to bring in as many flights from as many spokes as possible. "Every new spoke generates exponential numbers of origin-destination possibilities." This type of multiplier arithmetic has led all airlines to push their hubs to the very limits of the airports' physical capacity, or beyond it. The FAA has criticized carriers for scheduling more flights for simultaneous departure or arrival than the facilities could reasonably handle.

An example of the intensity of hub scheduling is presented in Figure 16, comparing the volume of arrivals at the Atlanta hub in 1978 and in Spring 1987. In this period, total arrivals at that airport increased by 54%. In 1978, there were only five hours during the day with fifty or more scheduled arrivals. By 1987, all sixteen hours between 7 a.m. and 11 p.m. exceeded that level of activity. With this type of day-long, sustained peak there is little "catch-up" time to absorb off-schedule operations. The hub becomes vulnerable to a snow-balling of delays.

Moreover, with the dominance of hubs, any delays experienced at those locations quickly spill over to the rest of carriers' route networks. For example, in the case of TWA's Summer 1987 schedule, 79% of its domestic flights operated to, from, or through its St. Louis hub. The risk of a systemwide chain reaction of delays is obvious.

As previously mentioned, hub development has had its positive aspects, in terms of the permutations of new and increased patterns of connection service. Unfortunately, however, the pressure to build hubs to the limits of airport tolerance has also created the negative factor of congestion.

Some of the proposed solutions to congestion seem oriented more to past scheduling practices than to the present characteristic of hubs. This applies particularly to proposals to raise landing fees in peak hours, and

44. Kjelgaard, supra note 27, at 11.
45. FESTIVE FLYER MAGAZINE, July 1987, at 48.
thus spread out airport utilization. This solution might be effective in some non-hub situations. However, as indicated by Figure 16, the typical major hub has developed wave after wave of connection banks throughout the day, with the result that the "peak" is sustained through the day, rather than limited to just a few hours. It is not clear, therefore, how an attempt at hourly variation of landing fees would relieve this typical pattern of major hub congestion.

There is another, partly related way in which deregulation has contributed to congestion: the pressure it placed on airlines to shift to smaller planes. In the past, as airlines modernized their fleets, they kept moving to planes with larger seating capacity so that the number of departures did not have to increase in proportion to market growth. Deregulation, with its emphasis on frequency into hubs, replaced previous fleet planning policies with a new emphasis on smaller aircraft.

In the eight years 1970-1978, average plane size increased by 33%; whereas in the eight deregulated years 1978-1986, the increase was only 12% (Figure 17). Moreover, even the latter increase was inflated by deliveries in the initial years of deregulation of aircraft ordered before 1978. In the four-year period ending in 1986, there was no net increase in aircraft size. Based on new aircraft orders outstanding as of mid-1986, it appears that the lack of growth in average plane size may continue for several more years.46

Deregulation's discouragement of larger aircraft is evident in an increase in the required level of departures. Between 1970 and 1978, industry departures actually declined.47 In contrast, between 1978 and 1987, departures increased by 44%, as indicated in Figure 15. Moreover, as also indicated in Figure 15, the departure increase has been concentrated at large and medium hubs, where increases have averaged 62% and 56% respectively.

Still another way in which deregulation has intensified congestion is by its discouragement of night-coach service, a type of off-peak operation which in the past reduced the load during daytime hours. Night coach was effective before 1978, because of the pricing inducement it offered to compensate for inconvenient departure/arrival times. However, under deregulation, indiscriminate, deep fare discounting at all hours of the day has reduced any incentive to travel late at night. To illustrate, Figure 18

46. See Aviation Information Service, Ltd, Turbine Airliner Fleet Survey (July 1, 1986). This analysis indicated that the average seat capacity of planes operated by U.S. carriers on that date was approximately 161 seats, while the average size of the planes then on order for future delivery was 157 seats.

47. Compare Air Transport Association, Airline Facts and Figures (1970) with Air Transport Association, Airline Facts and Figures (1978). In 1970 there were 5,120,000 departures. This number had declined to 5,013,000 by 1978.
### Figure 16

**Summary of Arrivals at Atlanta Airport, by Hour 1978 vs. 1987**

<table>
<thead>
<tr>
<th>Hour</th>
<th>Dec. 1978</th>
<th>March 1987</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>5:00 AM</td>
<td>20</td>
<td>9</td>
<td>-11</td>
</tr>
<tr>
<td>6:00 AM</td>
<td>0</td>
<td>7</td>
<td>+7</td>
</tr>
<tr>
<td>7:00 AM</td>
<td>1</td>
<td>52</td>
<td>+51</td>
</tr>
<tr>
<td>8:00 AM</td>
<td>33</td>
<td>58</td>
<td>+25</td>
</tr>
<tr>
<td>9:00 AM</td>
<td>75</td>
<td>73</td>
<td>-2</td>
</tr>
<tr>
<td>10:00 AM</td>
<td>12</td>
<td>54</td>
<td>+42</td>
</tr>
<tr>
<td>11:00 AM</td>
<td>56</td>
<td>75</td>
<td>+19</td>
</tr>
<tr>
<td>12:00 N</td>
<td>29</td>
<td>56</td>
<td>+27</td>
</tr>
<tr>
<td>1:00 PM</td>
<td>35</td>
<td>57</td>
<td>+22</td>
</tr>
<tr>
<td>2:00 PM</td>
<td>42</td>
<td>66</td>
<td>+24</td>
</tr>
<tr>
<td>3:00 PM</td>
<td>48</td>
<td>81</td>
<td>+33</td>
</tr>
<tr>
<td>4:00 PM</td>
<td>39</td>
<td>88</td>
<td>+49</td>
</tr>
<tr>
<td>5:00 PM</td>
<td>61</td>
<td>60</td>
<td>-1</td>
</tr>
<tr>
<td>6:00 PM</td>
<td>25</td>
<td>70</td>
<td>+45</td>
</tr>
<tr>
<td>7:00 PM</td>
<td>78</td>
<td>66</td>
<td>-12</td>
</tr>
<tr>
<td>8:00 PM</td>
<td>6</td>
<td>60</td>
<td>+54</td>
</tr>
<tr>
<td>9:00 PM</td>
<td>43</td>
<td>54</td>
<td>+11</td>
</tr>
<tr>
<td>10:00 PM</td>
<td>6</td>
<td>68</td>
<td>+62</td>
</tr>
<tr>
<td>11:00 PM</td>
<td>70</td>
<td>0</td>
<td>-70</td>
</tr>
<tr>
<td>Midnight or later</td>
<td>7</td>
<td>3</td>
<td>-4</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>686</td>
<td>1057</td>
<td>+371</td>
</tr>
</tbody>
</table>

Number of hours, with 50 or more arrivals: 5, 16

Source: Official Airline Guide.

compares the proportion of night coach flights on specified long haul routes in 1978 versus 1987.

### C. OTHER SERVICE PROBLEMS

While delays have represented the most serious service problem, there have also been consumer complaints about various other aspects of service. During the first five months of 1987, complaints to the Department of Transportation increased by 81% over the same period of 1986.\(^{48}\) In May 1987, the Secretary of Transportation wrote to the airlines, calling upon them to "reduce the level of passenger dissatisfaction." Among the areas cited as needing attention were questionable practices involving refunds for canceled flights, compensation for lost baggage, refunds on discounted tickets, and inadequate availability of no-

---

Figure 17
Change in Average Aircraft Size, Before and After Deregulation

<table>
<thead>
<tr>
<th>Year</th>
<th>Average Seats per Mile Flown</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>110</td>
</tr>
<tr>
<td>1971</td>
<td>118</td>
</tr>
<tr>
<td>1972</td>
<td>121</td>
</tr>
<tr>
<td>1973</td>
<td>127</td>
</tr>
<tr>
<td>1974</td>
<td>132</td>
</tr>
<tr>
<td>1975</td>
<td>135</td>
</tr>
<tr>
<td>1976</td>
<td>139</td>
</tr>
<tr>
<td>1977</td>
<td>143</td>
</tr>
<tr>
<td>1978</td>
<td>146</td>
</tr>
<tr>
<td>1979</td>
<td>149</td>
</tr>
<tr>
<td>1980</td>
<td>153</td>
</tr>
<tr>
<td>1981</td>
<td>157</td>
</tr>
<tr>
<td>1982</td>
<td>163</td>
</tr>
<tr>
<td>1983</td>
<td>166</td>
</tr>
<tr>
<td>1984</td>
<td>165</td>
</tr>
<tr>
<td>1985</td>
<td>166</td>
</tr>
<tr>
<td>1986</td>
<td>163</td>
</tr>
</tbody>
</table>

Change in size from 1970 to 1978: +33%
Change in size from 1978 to 1986: +12%

Source Derived from data of Air Transport Association

smoking seats. The Secretary warned that if improvements were not made, "we will not hesitate to refer a matter to our enforcement officer for action."49 By the summer of 1987, concerns about airline service had further escalated. A Newsweek article commented: "The skies of America are seriously troubled. Close calls are soaring, delays horrendous, maintenance shoddy, customer service bad and getting worse."50

It is not suggested that the airlines have been deliberately downgrading the quality of their service out of cavalier disregard for consumer reaction. Rather, this deterioration reflects the economic pressures on the airlines, stemming from the "destructive competition" referred to earlier. Much of airline operating cost is beyond the short-run control of airline management (e.g., fuel prices, landing fees, aircraft acquisition). When faced with inadequate financial margins, the main area in which an airline can seek relief is labor cost. Hence, when financial margins narrow, airlines have little choice but to tighten up on manning standards wherever possible. This necessarily shows up in deterioration of service quality.

Airline service was an area in transition in 1987. In addition to the increased public reporting of service factors required by the DOT, the carriers themselves have increasingly addressed service problems. Indeed, toward the end of 1987, airline marketing was increasingly focused on service quality claims.

This of course is a welcome development for passengers. At the same time, it must be noted that the increased emphasis on service has an impact on cost. Thus, if service standards are in a state of transition to higher levels, unit cost levels may be expected to shift upward as well.

VII. THE MIXED EFFECT OF Deregulation ON EFFICIENCY AND COST

Deregulation clearly brought pressure to reduce labor costs. New entrants had the cost advantage of non-unionized employees, which meant more flexible work rules as well as lower wages. This forced the more established airlines to seek, and their unions to yield, concessions to at least partly equalize labor costs.

The highly visible gains in this factor have created the impression that deregulation has resulted in lower costs generally. However, there have been a number of areas in which deregulation has increased cost. Two of the more significant involve different versions of curtailed "economy of scale." One is the loss of "scale" in aircraft size, as deregulation has forced a shift to smaller planes. The other is a loss of scale in station size, as deregulation has forced airlines to extend their systems to a large number of low-activity stations. Each is discussed separately below.

A. EMPHASIS ON SMALLER PLANES

Reference has been made above to the pressure under deregulation for smaller planes. Michael Levine has pointed out that: "[The surviving airlines] have acquired large fleets of smaller narrow-bodied DC-9's and Boeing 737's, sold their large 747's, and substituted narrow-bodied aircraft or smaller Boeing 767's for larger wide-bodied aircraft on many non-hub long haul flights." 51 A principal reason for this shift has been the proliferation of hub-and-spoke scheduling, and the need to maximize spoke routes (and their frequencies) in order to have as many flights as possible feeding into the successive waves of connections. Since this meant a subdivision of traffic volume among more frequencies, smaller planes became necessary in order to obtain adequate load factors.

However, there has been a hidden cost in this shift to smaller planes.

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52. Alfred E. Kahn, William A. Patterson Transportation Lecture, Northwestern University, at 13 (April 28, 1982).
Figure 18
Examples of Reduced Late Night Schedules Since Deregulation

<table>
<thead>
<tr>
<th>Route</th>
<th>1978</th>
<th>1987</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>New York-Miami:</td>
<td>27%</td>
<td>4%</td>
<td>-23 pts.</td>
</tr>
<tr>
<td>New York-San Francisco</td>
<td>21</td>
<td>8</td>
<td>-13 pts.</td>
</tr>
<tr>
<td>New York-Atlanta</td>
<td>20</td>
<td>3</td>
<td>-17 pts.</td>
</tr>
<tr>
<td>Average</td>
<td>22%</td>
<td>3%</td>
<td>-19 pts.</td>
</tr>
</tbody>
</table>

Source: Official Airline Guide

For any given "state-of-the-art" level of technology, the operating cost per seat-mile is normally higher for small aircraft than for larger aircraft. As noted by Dr. Kahn, "there are enormous economies associated with the size of plane, up to the limit of the biggest planes available."\textsuperscript{52} The shift away from large planes has thus meant foregoing these "enormous economies." This sub-optimization of aircraft size is particularly significant because of the long-term nature of fleet planning decisions. Once acquired, airline fleets have had useful lives of twenty years or more, so that the aircraft decisions made in recent years will affect airline operating cost and efficiency for several decades.

Moreover, fleet planning decisions will affect cost in indirect as well as direct ways. Smaller planes will require more departures to handle any given level of future traffic. This will translate into a need for more airport runway capacity, more gates, more ramp equipment—all of which will end up in the airline cost structure.

\textbf{B. Impact of Low-Activity Stations}

Deregulation has forced airlines to develop routes on a geographically extensive rather than intensive basis. Each airline has found it competitively necessary to add large numbers of new stations to its system, many of which are served only to and from the carrier's principal hub. As a result, there are many stations with only a few daily departures for any given carrier—a level of activity that does not permit efficient spread of rentals, supervisory costs, or other fixed and overhead station expenses.

Figure 19 shows how the pattern of station activity has changed for TWA between 1977 and 1987. Though that carrier's total domestic departures increased by only 11% in that period, the 1987 departures were spread over more than twice as many stations. In 1977, only 22% of the
cities served by TWA had fewer than five daily departures. By 1987, 44% of its cities were in this low-activity category.

**Figure 19**

**Domestic Cities Served by TWA, Classified by Departure Volume**

<table>
<thead>
<tr>
<th>Daily Departures</th>
<th>Number of Cities</th>
<th>Percent of Cities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fewer than 5</td>
<td>7</td>
<td>33</td>
</tr>
<tr>
<td>5-9</td>
<td>5</td>
<td>28</td>
</tr>
<tr>
<td>10-19</td>
<td>6</td>
<td>10</td>
</tr>
<tr>
<td>20 and over</td>
<td>14</td>
<td>4</td>
</tr>
<tr>
<td>Total</td>
<td>32</td>
<td>75</td>
</tr>
</tbody>
</table>

Source: TWA timetables

Note: Nine of the cities with under five departures in 1987 had been added to the TWA system with the acquisition of Ozark Airlines. If consideration is given only to cities served by TWA in 1986 just before the Ozark additions, there were twenty-five cities with under five daily departures, 38% of TWA’s domestic cities at that time.

This development has been a direct result of the "free entry" of deregulation. Carriers found that they could no longer rely on interline connections to provide traffic "feed" from cities they did not themselves serve. The only way a carrier could depend on participating in a specific city-pair's traffic was to have its own on-line access to both the origin and destination (except where it could achieve a similar result via a codesharing, affiliated commuter). As a result, all major carriers have had to extend their routes, not only to virtually all large cities, but to many secondary and tertiary ones as well.

On the positive side, this has meant that passengers now have a greater prospect of making on-line instead of interline connections, and this indeed has been cited as one of the benefits of deregulation. However, the negative side is the cost involved in this geographically dispersed route structure—the reduced efficiency associated with many low-activity stations.

### C. OTHER FACTORS

Other hidden costs of deregulation include:

- **Hub Congestion.** The Air Transport Association has estimated that delays cost the industry $2 billion in 1986.53 Because of its contribution to congestion and delays, some part of this cost must be charged against deregulation.

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• Lack of Stability in Operations. Costs are involved in the constant changes in routes, schedules, and pricing which have characterized deregulation.

• Travel Agent Commissions. The confusion in fares has increased the proportion of passengers dealing through travel agents, with a consequent increase in commission costs. Between 1978 and 1986, the average commission cost per passenger-mile increased by $2^{1/2}$ times.54

D. GENERAL COMMENT

The emphasis herein on the hidden costs of deregulation is not meant to suggest that on balance, there has been an actual net increase in the overall cost of airline operations. Rather, the main point is that the widespread impression of sharply reduced costs is by no means clearly established. The largest factor contributing to that impression is the reduction of labor cost, and admittedly that is a large component of the airline cost structure. However, as discussed above, there are various other areas where costs have increased. Furthermore, the improvements in labor costs are not necessarily permanent. A recent comment by First Boston Corporation is relevant:

As new hires being paid “B” scales make up a greater percentage of the work force, they’re demanding—and getting—higher rates of pay. With the new entrants dead and the industry more concentrated, it is tougher to convince labor of the need to reduce labor costs. And as labor integration takes place following a merger, labor costs rise.55

The point is sometimes made that airline productivity (e.g., as measured by revenue ton miles generated per employee) has improved since 1978, and that this is evidence of increased efficiency triggered by deregulation. However, as with other trends discussed previously, the post-1978 change is not entirely meaningful when viewed by itself (i.e., when it is not related to the industry trends already existing before deregulation.) Figure 20 places the recent experience into perspective, by comparing the productivity trend for the eight years after deregulation, with the same period of time before deregulation. The gain in productivity was actually greater in the earlier period, thus casting further doubt on the general impression that deregulation has had a net overall benefit for airline efficiency.

Furthermore, by mid-1987 there were signs that costs would start increasing because of a renewed emphasis on service rivalry. For example, Continental (a carrier with a low cost reputation) announced in September 1987 a broad campaign to spend significant sums to improve its service. Among other things, it reduced aircraft utilization by setting aside

54. Airline Economics Incorporated, AIRLINE Q., Summer 1987, at 34.
### Figure 20
Change in Revenue Ton Miles per Employee, Eight Years Before Deregulation vs. Eight Years After Deregulation

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue Ton Miles ( Millions)</th>
<th>Employees</th>
<th>Ton Miles per Employee</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>20,186</td>
<td>297,374</td>
<td>67,881</td>
</tr>
<tr>
<td>1971</td>
<td>20,906</td>
<td>292,185</td>
<td>71,551</td>
</tr>
<tr>
<td>1972</td>
<td>22,805</td>
<td>301,127</td>
<td>75,732</td>
</tr>
<tr>
<td>1973</td>
<td>23,928</td>
<td>311,499</td>
<td>76,816</td>
</tr>
<tr>
<td>1974</td>
<td>23,900</td>
<td>307,318</td>
<td>77,770</td>
</tr>
<tr>
<td>1975</td>
<td>23,534</td>
<td>289,926</td>
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<td>1976</td>
<td>25,709</td>
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<td>1977</td>
<td>27,583</td>
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<td>1978</td>
<td>31,095</td>
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Eight-year change (percent) +39%

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<td>1986</td>
<td>48,828</td>
<td>421,686</td>
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</table>

Eight-year change (percent) +23%

Source: Calculated from data of Air Transport Association

eleven planes and crews at hub airports, with four always ready as spares. In full page ads, it stated: “Service doesn't come cheap. But we’re not skimping on its cost. In fact, we’re investing over $1.25 billion during 1987 alone as part of our commitment to the air traveler.”

Here again, as with labor costs, some of the “austerity” measures taken by airlines when deregulation began were not necessarily permanent changes in the industry cost structure. On the other hand, some of the cost-increasing aspects of the deregulated industry (e.g., the emphasis on small planes in recent fleet programs) are built into industry costs on a much more structural and long-term basis. In short, there is reason to question the degree to which deregulation has had a net favorable impact on airline costs.

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VIII. COMMENTS ON CLAIMED BENEFITS OF Deregulation

This article has pointed out various ways in which deregulation has failed to perform in the manner promised by its sponsors. Yet it is much more common to hear highly favorable appraisals of deregulation. Most are in the nature of editorial assertions, without specific evidentiary support. However, a study released in 1986 did attempt to measure tangibly the effects of deregulation, and concluded that it had benefitted the traveling public to the extent of about $6 billion per year, and had benefitted the industry by a profit improvement of about $2.5 billion per year. This study was prepared by Steven Morrison and Clifford Winston and was published by the Brookings Institution.\(^58\)

This study has been widely quoted. Since these claimed benefits are so at variance with the conclusions of this article, it is relevant to discuss the derivation of those claims. The following sections discuss the main components of the claimed benefits and raise serious doubts concerning their credibility.

A. Benefits Claimed for Travelers

Of the $6 billion in annual savings estimated for the traveling public, about 80% is claimed for business travelers rather than personal/pleasure travelers. The study states, "the benefits from deregulation largely accrue to business travelers because of improved service convenience attributable to the accelerated development of hub-and-spoke operations and to frequency improvements in low-density markets."\(^59\) The study places a dollar value on the reduced time between departures resulting from increased frequency of service. The claimed increase in productive business time is then assigned a monetary value equivalent to about one and a half times the average hourly wage of business travelers. This leads to a calculated total benefit from increased frequency of about $4 billion annually.

The basic premise—that the reduced time between departures translates into increased productive time for the business traveler—has general validity, but needs far more qualification than has apparently been given to it in this study. If a new schedule is added at mid-day on a route which previously had only morning and evening schedules, there would surely be a potential gain in business traveler productivity. But if, on the other hand, a new schedule is added at 3 p.m. on a route which already had a 5 p.m. nonstop, it is not clear that this would translate into a meaningful gain in a business traveler's productive time. (This new departure


\(^{59}\) Id. at 33.
option, while reducing the business time available at the origin city, would provide an arrival too late to add meaningfully to the business day at the arrival city.) More generally, for trips outbound from the traveler's place of business, the traveler usually has some ability to plan his office workday around the departure time of available flights, so that the time interval between departures does not end up as a total loss of productive time.

In any case, there is a more serious drawback to the premise of the Brookings study. The very increase in hub-and-spoke frequencies which played so large a part in the study's calculations has been an important contributor to the congestion and delays which by 1987 had become a matter of widespread concern. While reducing the time interval between published departure times, the increased hub-and-spoke frequencies have increased the actual delay time at the gate, and in runway queues—a form of lost time that is especially costly to business traveler productivity.

In this connection, a 1987 survey of frequent flyers indicated that negative responses on the matter of deregulated service convenience outweighed favorable responses by a ratio of over three to one. The survey covered 15,000 frequent flyers.\textsuperscript{60} When asked to rate the effect of deregulation on service convenience, 68\% of the respondents indicated that they found deregulated air service "less convenient and enjoyable." Only 19\% found deregulated air service to be more convenient and enjoyable. (The remaining 13\% indicated they found no difference or had no opinion.) These results are diametrically opposite to the finding of the Brookings study that business travelers have derived a large benefit (worth $4 billion per year) from "improved service convenience."

The remaining component of the claimed benefit for travelers (roughly $2 billion of the $6 billion total) was attributed to savings in fares. This estimate was arrived at by using fares through 1983 as a base for retroactively calculating what fares might have been back in 1977, if deregulation had then been in place. These hypothetical 1977 fares were then compared with the actual fares of that year to arrive at the claimed savings.

This approach treated the fares up to 1983 as representing a sustainable level. It thus failed to consider the widespread impact of "fare wars" which reflected below-cost pricing. Sections IV and V of this article have indicated the extent to which fares through 1983 lagged behind cost increases, and cited recent indications of a catch-up in fare escalation. In other words, the base which the Brookings study used to represent deregulated pricing was abnormally depressed, and therefore the use of that

\textsuperscript{60} Frequent Flyer Magazine, Sept. 1987, at 48.
base over-stated the fare savings that could be counted upon as an ongoing benefit.

B. **FINANCIAL BENEFITS CLAIMED FOR THE AIRLINE INDUSTRY**

The Brookings study claimed that deregulation increased airline profits by at least $2.5 billion per year. This is sharply at variance with the actual financial results of the industry, as summarized above in Figures 10 and 11. In the first eight years of deregulation, the industry had a cumulative after-interest loss of over $6.7 billion, compared with a profit of $2.2 billion for the same period just before deregulation. Figure 10 also indicates that the eight years since deregulation have been far worse financially than any other eight-year period in airline history.

The Brookings study concedes that its finding of large financial improvement "might appear somewhat surprising in view of the fact that the industry actually lost money." But it attempts to overcome that surprise by blaming the poor financial performance of the early 1980s on external factors—largely "fuel price increases and a recession." However, these two factors do not provide adequate explanation for the diametrically opposite directions of actual vs. claimed financial effects. Significantly, the two factors of fuel prices and recession had disappeared by the time the Brookings study was published. By 1986, fuel prices had dropped sharply from their 1981 peak and the recession had been over for several years. Yet the industry in 1986 still did not achieve earnings sufficient to cover its interest payments. The after-interest profit margin—which had been 2.7% in 1977—was negative 0.7% in 1986.

In its effort to find external explanations for the carriers' poor financial results since deregulation, the Brookings study totally ignored the adverse financial impact of the below-cost pricing mentioned above. The CAB in its final report to Congress stated: "The carriers' losses indicate that fares throughout this period did not fully cover costs (including the capital costs of the aircraft)." As noted in Section IV above, Alfred Kahn has referred to the relationship between "deep, intense price competition" and the fact that carriers have been losing money.

Surely fare wars have been a by-product of deregulation. (Indeed, a primary purpose of the prior regulatory framework was to prevent uneco-
nomic pricing.) In opening the door to fare war pricing, deregulation contributed directly to the poor financial results of the carriers since 1978. Yet the Brookings study ignored this, persisted in claiming that deregulation had improved industry earnings, and sought to blame actual losses on external factors which were already on their way out of the picture. In short, the study’s claims of large benefits to travelers and to the industry are totally lacking in credibility, for the reasons discussed above.

IX. FUTURE IMPLICATIONS OF AIRLINE DEREGULATION

It is impossible at this writing to predict with assurance the eventual financial and public service consequences of deregulation. The industry is moving into totally uncharted territory, as it becomes an oligopoly of five or six major carriers, operating free of regulation.

It is probable that the average level of fares will increase. The CAB’s 1975 report on Regulatory Reform warned: “Without the continuous threat of new entry in all markets, market structure becomes quite static. Incumbent carriers quickly discover, as the regulated carriers have, that any price reduction leads to retaliation.” 66 More recently, Alfred Kahn commented: “When you have the same six carriers meeting each other in market after market, there is danger of softer competition. It’s not in their interest to insult one another excessively.” 67

Indeed, by September 1987, the New York Times referred to “climbing air fares,” and stated:

These actions are raising concerns among Government officials, analysts and other experts that the top eight carriers are beginning to act like a price-setting oligopoly—an outcome opposite from what was envisioned when the airline industry was deregulated in 1978 in an attempt to foster competition and cheaper fares. 68

Whatever the future level of average fares, there is in any event the continued prospect for wide disparities in pricing between individual routes. Long haul fares will probably continue to reflect the pressure of competition, since those routes have multiple-carrier service via the various hub routings. However, if downward pricing pressure continues to push fares in those markets below full costs, then some subsidization by abnormally high fares in the less competitive local routes will remain necessary.

One possible pricing development with seriously adverse consequences would be “discount wars” seeking the preferred patronage of large corporations. The Government is already applying the bargaining

66. CAB STAFF REPORT, supra note 8, at 126-27.
"muscle" of its large travel budget, by giving preferential contracts to whichever carrier grants the most generous discount on specified routes. If a similar practice becomes widespread for the patronage of large corporations, it will open up a new dimension of price war, conducted on a wholesale, rather than retail, level. Since corporate and government travel is not significantly price-elastic, any discounting for this market is basically a source of yield erosion which will have to be compensated for by charging individuals (and smaller businesses) more than their fair share of the industry's cost.

The pressure for over-capacity will probably persist, despite the more concentrated industry. Even with a handful of carriers, there will remain the marginal-cost temptation to gain market share by increasing flight frequencies. Over-capacity pressure may, therefore, keep industry earnings below a fully adequate level. Alternatively, excess capacity may lead to overall fare levels higher than otherwise necessary, as the carriers pass along the cost of surplus capacity through fare increases.

One thing can be said with certainty: the nature of the deregulated industry is radically different from that forecast by the deregulators. It is not the market of open, continual free entry by new entrepreneurs which was predicted. The public does not have the safeguard of "contestability" to replace the safeguards it had under regulation. Even some of the principal sponsors of deregulation have by now conceded that the concept of contestability in this particular industry was flawed.69

It is possible that air service and its pricing may become satisfactory for the public as a whole. However, there cannot be any assurance that this will be the case, and there is no longer a governmental structure to rectify inadequacies or inequities that may negatively impact the traveling public. Some individual communities will remain particularly at risk of deteriorating service and/or inequitable pricing.

During 1987, the word "re-regulation" was beginning to appear. As noted at the beginning of this article, there is no realistic outlook for rebuilding the framework of regulation that was dismantled in 1978. However, there are certain forms of more limited regulation which are feasible and which could serve the public interest.

In the area of pricing, for example, there could be re-established a proscription against preferential pricing—and this could help guard against corporate-travel discount wars, which would erode yields and force a disproportionate pricing burden onto the individual traveler.

69. See, e.g., Levine, supra note 51, at 480; see also N.Y. Times., supra note 68, at A1 ("The large airlines have come to control pricing in major markets in a way that few foresaw when the industry was deregulated, said Elizabeth E. Bailey, dean of Carnegie-Mellon University's Graduate School of Industrial Administration and a former vice chairman of the Civil Aeronautics Board.").
In the area of scheduling, authorization could be renewed for airlines to rationalize capacity levels through joint, interline agreements—subject to DOT approval, after public negotiations. This could help reduce the waste of excess capacity, ease airport/airway congestion and delays, conserve fuel, and improve the long term economics of the carriers.

The matter of price disparity between different city-pair markets would be more difficult to deal with. It may nevertheless have to be addressed, through some form of legislation that would restore the principle that the public as a whole should get the benefit of favorable pricing and not merely the public in selected markets.

It will not be easy to find the middle ground which will overcome the more serious problem areas of deregulation, while leaving ample latitude for the exercise of management initiative and creativity. This makes it all the more important that the results of the past eight years be studied fully and objectively, in order to understand better the dynamics that actually govern the air transport marketplace, and to recognize the extent to which those dynamics diverge from deregulation theories.
Airline Deregulation—A Mixed Bag, But A Clear Success Nevertheless

Alfred E. Kahn*

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I. INTRODUCTION

It is probably not surprising that Melvin Brenner and I—one a strong opponent, the other an active proponent and practitioner of airline deregulation—should each find that subsequent experience has vindicated his

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position. The reader however, should not, be asked to add up our two views of the facts and, figuratively, divide by two. Therefore in this comment on Mr. Brenner's piece, I will acknowledge the blemishes and imperfections in the ten year record\(^1\) and the problems and uncertainties that remain, while at the same time documenting my own conviction that it is, on balance, a record of substantial success.

In so doing, I will concentrate primarily on Brenner's factual depiction of the recent performance of the industry; I will make no effort systematically to appraise the fairness with which he has characterized the expectations (or "promises") of the proponents of deregulation about how it would work out, for two reasons:

First, while it is fairly easy, by assembling a collage of views expressed here and there by one or another of the many supporters of deregulation (including this one) to put together a picture like the one he has drawn, it would take a massive effort to document my general reaction that Brenner has, nevertheless, constructed a strawman. I believe it will suffice merely to pause occasionally and demonstrate to what an extent it is indeed a caricature of the views I expressed at the time.\(^2\)

Second, there can be no quarrel with Mr. Brenner's general proposition that we proponents of deregulation did expect elimination of the comprehensive governmental restrictions on entry and price competition to bring the public very large benefits. I am confident he would agree, therefore, that the more important part of his article, by far, is his review of the recent historical record, which he believes demonstrates that this radical change in policy was a mistake.

While I propose to respond, point by point, to the list of "promises" and "facts" of deregulation with which Brenner introduces his article, I will only occasionally supplying a correction to his characterization of the "promises," as far as my own predictions were concerned. I will, however, comprehensively review his "facts" and in so doing will offer the basis for my own conclusion that those expectations have, on the whole,

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1. The Deregulation Act was passed in October 1978, but, as I will observe, the process began about two years earlier.

2. No doubt some of the pro-deregulation rhetoric suggested that some proponents indeed expected the change in policy to usher in a paradise on earth, problem-free and calling for no further governmental scrutiny or interventions. The general philosophical position of such leading proponents of deregulation as Ralph Nader's Public Citizen, the Consumer Federation of America and Common Cause, however their enthusiastic support, for example, of vigorous government enforcement of the antitrust and consumer protection laws—should make Mr. Brenner's readers suspicious that they had any such naive expectation.

been strikingly realized. Specifically, I will (following Mr. Brenner's own list) confront the expectation that a deregulated industry would:

1. be more competitive (it is);
2. offer substantial reductions in average fares (it has);
3. distribute its benefits more equitably (this one is more complicated, but, it general, it has);
4. provide new lower fare/quality options (it has);
5. be more efficient (it is);
6. be less prone to engage in non-price, cost-inflating competition (it is);
7. continue, on the whole, to serve the network it previously served (it does);
8. not subject the industry to severe financial distress (on this one we were wrong, but the one thing I did not do was promise either the industry or its employees a rose garden. The critical question is whether this financial distress threatens to deprive the public of the enormous benefits of deregulation. My—somewhat peremptory—answer is that it does not).

The foregoing list omits explicit reference to the quality (and safety) of service, except as it is implied under points 4, 6 and 7. In view of the widespread conception—in some measure justified—that quality has deteriorated, I assemble some of the pertinent evidence under topic 5, since a reduction in cost associated with a decline in service quality is not necessarily an improvement in efficiency.

II. COMPETITION AND CONCENTRATION

A. THE WORLD ACCORDING TO BRENNER (HEREINAFTER "WAB")

The promise: "wide open competition," disciplined by free entry.

The fact: increased industry concentration, with "little future prospect" of significant new competitive entry.3

B. THE WORLD ACCORDING TO KAHN (HEREINAFTER "WAK")

Promise:

1. The natural structure of most airline markets, I observed, was monopolistic or oligopolistic—a market structure "simply not conducive to bitter-end price competition."4

4. This kind of structure could still be conducive to highly effective competition if only the government would get out of the way: the ease of potential entry into these individual markets, and the constant threat of its materializing, could well suffice to prevent
2. While counting on the relative ease of entry into airline markets to limit the exploitation of monopoly power, I repeatedly expressed skepticism about its adequacy.\textsuperscript{5}

The facts:

1. Bankruptcies and mergers have indeed, after an initial period of substantial deconcentration, left us with an industry somewhat more concentrated on a national level than before deregulation, as Brenner demonstrates.

2. The pertinent measure of concentration, however—changes in which he nowhere attempts to depict\textsuperscript{6}—is on individual routes. That is the measure of the availability of competitive offerings to travelers. The average number of carriers per route is apparently higher today than it was under regulation.\textsuperscript{7}

-monopolistic exploitation. Still, that kind of market situation...is simply not conducive to bitter-end price competition.


5. For example, in testimony before the House Aviation Subcommittee, I strongly supported the proposition that

"No automatic upward [pricing] freedom should be allowed in markets dominated by a single carrier."


In a memorandum to the Board on the eve of our decision to open up the transcontinental U.S. market to free entry, with World and Capitol promising to offer very low fares, I urged us to consider imposing some limitations on the permissible competitive response by the incumbent carriers, because of the likelihood that, if they were entirely free to do so, they would match the much lower fares on those particular routes, discriminatorily, and drive the new entrants out of business. I further expressed the opinion that if this happened, it was highly unlikely the incumbents would be deterred from raising their fares back to previous levels by the prospect that other entrants would be tempted to emulate World and Capitol, and risk suffering the same fate. Large segments of this memorandum are reproduced in Kahn, "Deregulatory Schizophrenia," 75 Calif. L. Rev., No. 3, forthcoming.

6. He does show how concentration has increased at the principal hubs, and that clearly suggests a troubling reduction in the competitive alternatives available to travelers on flights originating and terminating at those hubs. (Many of these changes have been effected by mergers that a Federal Government conscious of its continuing—indeed enhanced—antitrust enforcement responsibilities in a deregulated industry would not have permitted.) But this showing ignores the very marked increase in competition among offerings of flights over competing hubs.

7. Unfortunately most of the systematic evidence with which I am familiar dates back to 1984, and does not reflect the more recent wave of mergers:

a. According to the survey by John S. Strong, the average number of carriers serving each airport apparently increased between 1978 and 1984 by 31 percent at large hubs, 51 percent at medium hubs, 42 percent at small hubs, and 15 percent at nonhubs. J. MEYER, C. OSTER, The Effect on Travelers: Fares and Service, in Deregulation and the Future of Intercity Passenger Travel, 120 (1987).

b. The more recent compilation by Julius Maldutis, however, shows a sharp increase in the average concentration of business at individual airports between 1984 and 1987, mainly because of the wave of mergers that took place in that period. Hearings before the Senate Comm.
3. The point is that the removal of the pervasive regulatory restrictions on the operating rights and service offerings of incumbent carriers radically diminished the significance of the national concentration figures on which Brenner relies. The relatively small number of airlines were under regulation prevented from competing with one another; since deregulation they have been free to invade one another’s markets, offering whatever combinations of price and service they choose, and they have done so vigorously. Active competition among them has, therefore, sharply increased, and each is now a potential direct competitor of every other. Consider the implications for competition on the East Coast posed by American Airlines’ new hubs at Raleigh/Durham and Nashville, United’s at Dulles, and Continental’s (taken over largely from People Express) at Newark.8

4. These market interpenetrations show up indirectly in one aspect of Brenner’s own national concentration figures (his Figure 3), on which he fails to remark: there has been a significant turnover in the membership and relative positions of the top six carriers he lists. Of the top six on his 1978 list, three gained market share in the ensuing nine years and three lost it (TWA and PanAm substantially). Any one familiar with the histories of these companies during the intervening nine years will recog-

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on Commerce, Science and Transportation, 8 (Nov. 4, 1987) (statement of Julius Maldutis). On the other hand, he points out, a Boston/Phoenix passenger has a choice of nine hubs at which to make his or her connecting flight.

c. Between March 1, 1978 and March 1, 1984, the number of markets served by a single airline dropped from 3,978 to 3,592, while the number served by two airlines and by three or more increased, respectively, from 824 to 955 and from 356 to 876. U.S. General Accounting Office, Deregulation: Increased Competition Is Making Airlines More Efficient and Responsive to Consumers, Washington, D.C. 61 (Nov. 6, 1985).

d. A colleague of mine at National Economic Research Associates took a 20 percent random sample—admittedly a small one—from the 70 city-pair routes cited by Mr. Brenner in M. BRENNER, J. LEET, E. SCHOTT, AIRLINE Deregulation (1985) and found that the average number of airlines providing them with single-carrier service increased from 3.4 in 1977 to 6.6 in 1986—nearly a doubling in this particular measure of the competitive alternatives available to travelers. To some extent the measure he chose (because it would have been much more difficult to count all the available interline connecting possibilities) may have biased the result, because of the drastic decline in interlining after deregulation. On the other hand, single-carrier service is definitely more attractive to travelers than multi-carrier, and it is unclear how much competition is actually provided by carriers that can offer only a portion of an interline journey.

8. Significantly, while recognizing this phenomenon, Brenner ignores it totally when, after pointing out the fate of new airlines and the unlikelihood of significant further entries by them, he concludes that this experience “has invalidated the theory that market contestability would ‘police’ the market.” Brenner, supra note 3, at 194. I have no recollection that in expressing the expectation that the possibility of entry would prevent grossly monopolistic exploitation, the advocates of deregulation clearly distinguished the roles they expected would be played, respectively, by totally new entrants and by existing carriers invading one another’s markets. Manifestly, however, it is irrational to conclude, from the unlikelihood of the former, that the anticipated effectiveness of contestability has therefore been disproved.
nize what turbulence, travail, and entrepreneurial creativity lies behind both the gains and the losses. Moreover, the number one spot was taken over by a carrier, Texas Air, that was not on the list at all in 1978. Even the most casual newspaper reader knows what a vigorous price competitor Texas Air has been and, in large measure, remains.

5. The bankruptcies, mergers and acquisitions, at least some of which both Brenner and I lament, have largely been the consequence of the intensely competitive nature of the industry since deregulation.

6. They have also been permitted by a totally, and in my view indefensibly, complaisant Department of Transportation. It is absurd to blame deregulation for this abysmal dereliction.9

7. The industry remains to this very day far more intensely competitive than it was before 1978. Brenner cannot have it both ways—asserting or implying on the one hand that competition has proved to be a lost cause10 and, on the other, that it has been and remains to this very day11 catastrophically destructive of the industry's financial health.

8. He will undoubtedly retort, just as he did ten to fifteen years ago, that competition will eventually kill itself off and that concentration trends to date are only the harbingers of that ultimate outcome. To which I respond, just as I responded then: the possibility, which no one can deny with total certainty, that competition may one day prove not to be viable was hardly a reason to have suppressed it thoroughly in the first place, through regulation.12 The billions of dollars a year of benefits to consumers that deregulation has produced in the interim, and continues to produce to this very day (see Section II below), continue to vindicate that contention.

9. See, e.g., "Deregulatory Schizophrenia," supra note 5; Kahn, Subcommittee on Monop- nopolies and Commercial Law, Committee on the Judiciary, U.S. House of Representatives, on the Administration's proposed amendments to Section 7 of the Clayton Act, Feb. 26, 1986; Subcommittee on Antitrust, Monopolies and Business Rights of the Senate Committee on the Judiciary, on competitive issues in the airline industry, March 25, 1987; Subcomm. on Aviation of the Senate Comm. on Commerce, Science and Transportation, Nov. 4, 1987; Maldulis, supra note 76, at 9.

10. "It is inconceivable that Congress would have enacted deregulation if it were foreseen that the public would end up with neither the protection of regulation, nor the protection of vigorous multi-carrier competition." Brenner, supra note 3, at 186.

11. See id. at 202 (Figure 11) and my discussion below of the behavior of air fares through 1987.

III. FARE LEVELS

A. WAB:

Promise: "Deregulation would bring substantial fare reductions."
Fact: "deregulated pricing has not shown major improvement compared with prior trends."13

B. WAK:

The facts:

1. Brenner compares a 2.6 percent average annual decline in real—i.e., inflation-adjusted—yields between 1978 and 1986 with the 2.2 percent average annual decline in the 1970-78 period, as the basis for his conclusion that the rate of decline since deregulation has not been "materially different."14 His choice of 1978 for the dividing point is profoundly misleading. It was in early 1977 that the CAB, under my predecessor, John E. Robson, began to relax its previous strict controls on the offering of discount fares. The relaxation was far advanced by 1978.15 Manifestly the proper base year for these comparisons is, therefore, 1976, not 1978. The effect is dramatic: it drops the average annual rate of decrease during the prederegulation period, 1970-76, from Brenner’s 2.2 percent to 1.5, and raises the average annual change after deregulation—i.e., between 1976 and 1986—from Brenner’s 2.6 percent to 3.5.

2. One does not have to be an economist to understand the importance of "ceteris paribus." The very satisfactory decline in fares during the prederegulation decades (to which I referred favorably at the time16) represented primarily the contribution of technology—in the 1960s, primarily the jet revolution. After deregulation, in contrast, primary credit must go to the enormously accentuated incentives and pressures of com-

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14. Id.
15. The first major proposal, Texas International’s Peanuts fare, was approved in Feb. of 1977, and American Airlines’ Supersavers, which very shortly spread across the entire country, almost immediately thereafter. Strong, supra note 7a., at 109. Reading from a graph in the Strong study at 117, it appears that the percentage of travelers in the top 50 markets using discount fares rose from slightly over 20 percent in 1976 to about 48 percent in 1978; the corresponding respective percentages in the 51st to 200th markets were approximately 15 and 25, and in the 201st through 500th, perhaps 12 and 25 in these two years. According to the Air Transport Association, the proportion of revenue passenger miles at "reduced fares" increased from 36.9 percent of the total in 1977 to 45.6 percent in 1978. Statistics for earlier years are unavailable.
16. See Kahn, The Economics of Regulation, Vol. II, 100 (New York: John Wiley & Sons, 1971). In alluding to similar trends in the regulated industries generally, including airlines:

It bears repeating that these impressive accomplishments must reflect, above all, the enormous potentialities of the technology with which these industries work...
petition.\textsuperscript{17} As I have already observed, Brenner cannot have it both ways—claiming that deregulation has been a catastrophe because the price competition it unleashed has been so financially destructive to the carriers, on the one hand, and that is has not produced any real difference in the behavior of fares and costs, on the other.

3. Will it last? I have little doubt that the factors to which Brenner refers—the disappearance of most of the price-cutting new entrants and the marked reconcentration of the industry—will produce higher fares: I did indeed observe late in 1986 that yields at the levels then prevailing were not sustainable, because the industry as a whole was losing money. In fact, after dropping some eight percent in 1986 alone and actually running below 1986 levels during the first five months of 1987, average passenger yields improved markedly and had by September and October 1987 almost regained the levels of the corresponding months of 1985.\textsuperscript{18} But those 1985 levels would still have represented savings to airline passengers in 1986 alone of $11 billion. That is how much more they would have paid in that single year if average airline yields had merely remained constant in real terms, at 1976 levels. (Of course many fewer of them would have traveled in that event.)

IV. DISCRIMINATION AND INEQUITIES

A. WAB:

Promise: "Benefits of deregulation would be equitably distributed..."

Fact: "Serious inequities have developed between fares in markets with limited competition vis-a-vis the more intensely competitive markets."\textsuperscript{19}

B. WAK:

1. The benefits of price competition have indeed been unevenly distributed geographically, because the intensity of competition has varied substantially from one market to another.

2. The structure of fares has, however, come much more closely to track the structure of costs—reflecting the economies of distance, market density, and of serving discretionary as compared with business scheduling needs.\textsuperscript{20} Airline fares have also come much more fully to reflect the relative costs of providing carriage on and offpeak, first in openly quoted

\textsuperscript{17} See Meyer & Oster, supra note 7a, at 84.
\textsuperscript{18} Information from the Air Transport Association.
\textsuperscript{19} Brenner, supra note 3, at 182.
\textsuperscript{20} E. Bailey, D. Graham & D. Kaplan, Deregulating the Airlines (1985); see Strong, supra, note 7a., at 121-22.
fare differentials and second, and far more important, in the widely diverging availability of deeply discounted fares from flight to flight, depending upon the probability of the carriers being able to sell full-fare tickets.

3. In 1986, 90 percent of all passengers traveled on discount tickets, at an average discount of 61 percent below coach fare.\textsuperscript{21} Clearly, the benefits of price competition have therefore been extremely widely distributed. Prominent among the beneficiaries have been people of modest means—which surely accords with the usual conception of "equity."\textsuperscript{22}

4. The troublesome disparities that have emerged between fares in dense and thin markets are not wholly discriminatory. It costs more per passenger to provide service on small airplanes, serving thin routes with the frequency required to meet the needs of business travelers, than it costs on the dense routes, where it becomes economic to use larger planes.

5. It is by no means obvious to what extent travelers in the less competitive markets have actually been exploited because of the lesser intensity of competition for their patronage. That fares in the denser markets have gone down, dramatically, is unquestionable; that they have failed to go down as much in the thinner markets, or that unrestricted coach fares have actually increased (even in real terms) is likewise unquestionable.\textsuperscript{23} What is extremely dubious (and widely assumed), however, is that fares have gone up in the latter markets because they have gone down in the former. As Brenner puts it,

because these lower fares [i.e., in the competitive markets] are below the full average cost of many carriers, they have found it necessary to compensate,

\textsuperscript{21} Air Transport Ass'n, ANNUAL REPORT 1987 at 5.

\textsuperscript{22} Obviously also, with business travelers accounting for some one-half of the total, most of them too have been taking advantage of discount fares, and enjoying the additional compensation—for example, for the increased congestion and discomfort of air travel—of frequent flyer credits.

\textsuperscript{23} The increases have however been much smaller, on average and in real terms, than is generally assumed. Strong deflated the lowest unrestricted coach fares—which, recall, only a small minority of travelers pay—in a large sample of markets with the index of input costs on the basis of which they had previously been regulated, and found that, thus reduced to real terms, they declined by 9 percent on average between 1976 and 1984 in the top 50 markets, and rose by 3 percent and 6 percent respectively in medium-density and low-density markets. Supra note 7a, at 112-13, 121-22.

Incidentally, Brenner's comparisons almost certainly egregiously exaggerate these disparities, because—in sharp contrast with his Figure 8, which presents information about actual average yields per mile (thereby fully reflecting the influence of discount fares)—his market by market fare comparisons are of "the lowest one-way coach fare(s) available for travel during the following week" coach fares (footnote to Figure 7). Since 90 percent of travel in 1986 was at discount fares, and it is my impression that the preponderance of discounts offered by the major carriers are for round-trips, manifestly only a very small percentage of travelers—probably even on the thinner routes—paid the fares Brenner compares in Figure 7. Brenner, supra note 3, at 197.
by raising fares substantially in less competitive markets.\textsuperscript{24}

Again:

In short, some parts of the public get bargains, while other passengers are subsidizing those bargains by the steep escalation in their fares.\textsuperscript{25}

These assertions are economically ignorant. First, and less important, they ignore the fact that the identities of the airlines in the two categories of markets are not necessarily the same. There is no reason why, when United, Frontier, Continental and People Express became embroiled in intense price competition centered on Denver, USAir and Piedmont—both consistently extremely profitable carriers with the highest average yields per mile among the majors—should have been induced or required to compensate by increasing fares in their markets.

More generally, the assumption that high fares in some markets "subsidize" lower fares in others requires a belief that business would for substantial periods of time sell some services at prices below incremental costs and others at prices below profit-maximizing levels, then raise the latter only after and because competition had forced them to reduce fares in the former. Airline companies irrational enough to engage in either of these practices for any extended period of time would quickly be driven out of any businesses as competitive as this one.

6. On the contrary, if the introduction of intense price competition on the dense routes has any effect on prices on the thin ones, it is more likely to be to reduce than to increase them. When SuperSavers were introduced, first between New York and Los Angeles, it was not very long before transcontinental carriers serving Philadelphia and Boston came to the CAB and asked to be permitted to offer SuperSavers on those routes as well. Why? Because they were losing large chunks of their transcontinental traffic, since many of their previous passengers were now flying to New York in order to take advantage of the SuperSavers available from that city. The Board consented. Before long we had SuperSavers available between all major cities in the United States. There is a very strong tendency of discount fares to spread in this way from one market to another. Doubtless this factor—as well, of course, as the fact that most travel is on the dense, highly competitive routes—helps explain the fact that the overwhelming proportion of all travel is at fares far below the published coach level.

7. Competition in the real world is, always and inevitably, imperfect. The question for public policy is always whether the imperfections are so severe as to justify comprehensive regulation of the kind that we practiced in the airline industry before 1978—at costs to the economy at large

\textsuperscript{24} Id. at 195.

\textsuperscript{25} Id. at 198.
of billions of dollars a year. I find it significant, in this connection, that even Brenner is proposing not a return to the comprehensive cartelization that prevailed before 1978, but only some "middle ground which will overcome the more serious problem areas of deregulation, while still leaving ample latitude for the exercise of management initiative and creativity."26 On the other hand, whereas the imperfections of competition I have identified suggest the possible desirability of maximum fares on inadequately competitive routes (which I advocated at the time not be abandoned),27 Brenner's tastes run clearly to restrictions on competition—minimum fares, mandatory system-wide rate averaging and capacity restrictions. That kind of "partial re-regulation" is, I suggest, just about as feasible as partial pregnancy.

V. THE AVAILABILITY OF LOWER-FARE NO-FRILLS OPTIONS

A. WAB:

Fact: "By 1987, however, most of the new low-fare entrants had dropped out of the picture."28

B. WAK:

True, the People Express competitive option—uniform low fares, no meals, no free baggage handling—has proved not to be competitively viable, for a large number of reasons. One of the most important of these, however, has been the development of comparable options by the major incumbent carriers—very deeply discounted fares (below levels that even a lower-cost carrier like Peoples could charge on a uniform basis), with tighter seating, advance purchase and other restrictions, long lines, and so on. Business travelers complain, with some justification, that the resulting congestion and tighter seating have deprived them of the more comfortable options they previously enjoyed—a defect in the industry's performance since deregulation that we will trace in part below to major derelictions of government policy. The fact remains that, under pressure of competition, the airlines have also developed a variety of business, executive, and first class offerings, priced far more flexibly and made available in a far greater variety of ways than was permissible under regulation, as well as separate lines for such customers and—a very important compensation—frequent flyer benefits.

Brenner's proffered "factual" demonstration of the failure of deregulation to deliver on this particular promise obviously confuses the survival of low-fare no-frills carriers with that of low-fare no-frills service. The se-

26. id. at 227.
27. Supra note 25.
lectivity of this "evidence" will be obvious to any airline traveler or, indeed, to anyone who merely reads the newspaper advertisements of the trunk carriers, including the fine print.29

VI. EFFICIENCY AND COSTS

A. WAB:

Fact: "Deregulation did lead to lower labor costs—but this was substantially offset by hidden costs and inefficiencies..."30

B. WAK:

This is a ludicrously inadequate appraisal of a record of striking improvement in productivity and reduction in cost that can be attributed only to the undeniable increase in the intensity of competitive pressures on the carriers unleashed by deregulation and the freedom it conferred on them to control their own operations:

1. Between 1980 and 1983, United Airlines reduced its labor force from 50,000 to 42,000 while retaining essentially the same totality of operations. This alone amounted to a 20 percent increase in labor productivity. American Airlines reduced its labor force from 40,656 to 36,924 during the same period.31

2. Output has expanded so sharply that total employment in the industry has gone up—from 303,000 in 1976 to 422,000 in 1986, a 39 percent increase. Total revenue passenger enplanements went up 87 percent and revenue passenger miles 105 percent during the same decade.32 The difference between the first percentage increase and the other two provides a fair reflection of the productivity improvement enforced and made possible by deregulation.

3. United Airlines reported that by taking advantage of its newly conferred freedom to restructure its routes, it increased the daily average revenue-producing usage of its planes from 8.5 to 10.5 hours in the short space of two years.

4. Brenner’s only reference to the dramatic move to hub-and-spoke operations in this context is to cite it (correctly) as having increased con-

29. In short, the "fare-matching strategy of the incumbent carriers" that helped do in the low-fare specialists retained that option for the great majority of travelers. Mr. Brenner’s assertion that these Ultimate Supersaver offerings, however, retained all the "amenities" of full-fare travel is likely to elicit a sardonic smile from anyone who has enjoyed the narrower seating, long lines, fuller lanes, not to mention the various restrictions, including less than full refundability, associated with these options. Id. at 193.
30. Id. at 217.
31. AIR TRANSPORT ASS’N, ANNUAL REPORT 1981 at 6-7; AIR TRANSPORT ASS’N, ANNUAL REPORT 1984 at 4-5.
32. Supra note 21, at 3.
gestion and delay costs. This observation inexcusably ignores the principal motivation for that dramatic change and its enormous advantages—fuller utilization of larger and more efficient planes, made possible by combining at the hub traffic from each spoke to each destination, and the possibility of offering a wider range of destinations from all originating points, because of that same confluence of traffic.

5. Similarly, his only reference to the change in the use of equipment is to "less-than-optimum seat-mile costs because of the pressure for smaller planes." Brenner offers no support whatever for characterizing this change as inefficient, and ignores the fact that, on the contrary, deregulation has permitted a much more efficient adaptation of type of equipment to type of market. Smaller communities have of course complained about the loss of jets, but jets are uneconomic for short hops—indeed they were being pulled out of small towns for years before deregulation—and increasing fuel prices made them even more so.

6. Brenner's failure to cite the substantial increase in average load factors as relevant to the effect of deregulation on efficiency is particularly entertaining, in view of the confident predictions by its opponents that free skies would be filled with airplanes flying half empty. On the contrary, as its proponents pointed out at the time, it was under the previous regime that they were doing so, because regulation, by stifling price competition, encouraged inefficient competition in cost-inflating ways—specifically, by more intensive scheduling. As we did indeed predict—and as economic logic told us—price competition has driven break-even load factors up and scheduling competition down. The sharp increase in peak/offpeak fare differentials, likewise attributable to deregulation, has further contributed to this clear improvement in efficiency.

Brenner dismisses this striking vindication of the economic logic of deregulation as "almost meaningless" on the ground that "excess seats can be filled by virtually giving them away in price wars" and because the break even load factor has increased even more dramatically.

Higher load factors are not an unequivocal evidence of improved efficiency—not for the reasons Brenner adduces, but because they do involve some corresponding decline in the quality of service. But his

34. BAILEY, GRAHAM & KAPLAN, supra note 20, at 113, 119.
35. Brenner, supra note 3, at 206.
36. See, e.g., Kahn, Economics of Regulation, supra note 16, at 209-12, pointing out that if regulation prevents competition from driving price down either to marginal cost or to minimum average unit costs it encourages competition in ways—like denser scheduling—that drives costs up to those levels.
38. Brenner, supra note 3, at 206.
dismission of this clear evidence of fuller and physically more efficient use of capacity—over and above the fact that the airline companies have also increased the average number of seats per plane—on the ground that the seats have been "virtually given away" is economically ignorant. He does not suggest that these low fares have been below short-run or, indeed, even long-run marginal costs. Any economist would recognize at once that filling seats at least some of which would otherwise be empty with fares that exceed marginal costs represents an unequivocal improvement in economic efficiency (setting aside its effect on the quality of service, to which I will return).

Brenner's argument is, rather, that the financial health of the industry would have been better had competition not forced the carriers to do these things. I agree, and turn to his criticisms of deregulations in that respect in Section VIII, below.

7. We must of course confront on the other side the undeniable increase in congestion and delays during the last several years: lower costs achieved at the expense of quality of service are not an unequivocal evidence of improved economic efficiency. By the same token, neither are increasing congestion and inconvenience in themselves a sign of failure. After deregulation, low-cost, aggressively-competing airlines offered the public very low fares for necessarily correspondingly lower quality service—narrower seating, longer lines, fewer amenities. The deeply discounted fares with which the incumbent carriers responded could be justified likewise, at least partially, by the introduction of similar economies. The enormous response of travelers to the availability of these new options is a vindication of deregulation, not a condemnation of it.

8. At the same time, these annoyances have been the result also of major failures of government policy.

For one thing, after denying for many years the validity of the criticisms, the FAA conceded in 1987 that it was inadequately staffed with fully experienced flight controllers, and announced plans, in two separate stages, for sharply increasing their numbers.

Far more important, the most severe congestion has been at peak

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39. The same observation applies of course to safety. I refrain from discussing this aspect of the industry's performance since deregulation because Brenner does not claim that flying has become less safe—doubtless because in fact accident rates during the 1979-86 period have averaged some 35 to 40 percent below pre-deregulation levels. Calculations from annual reports on airline accidents and departures by the National Transportation Safety Board. See Morrison & Winston, Air Safety, Deregulation and Public Policy, 1988 BROOKING REV. 10; see also N. ROSE, FINANCIAL INFLUENCES ON AIRLINE SAFETY (M.I.T. Sloan School of Management Working Paper No. 1890-87) 1987.

travel times in and out of a few major airports. The FAA placed a large share of the blame for this on the scheduling practices of the airlines—observing, for example, that they typically scheduled many more flights in and out of those airports at such times as 8:00 a.m. and 5:00 p.m. than could possibly be accommodated even in good weather. Brenner in effect does the same: the fault, in his view, lies in competition and hubbing. An economist would quickly observe that the airlines were merely doing what they are supposed to do in a market economy—trying, under pressure of competition, to give travelers what they want. The fault lies, instead, in the failure of the pertinent government agencies to respond with minimum economic intelligence to the resulting queuing, which clearly reflects a situation in which demand outruns supply.

The inescapable inferences are two. On one hand, the pertinent authorities have failed sufficiently to expand airport capacity. On the other, the right to take off and land at congested airports at times of excess demand is underpriced. What is obviously called for is to price those scarce “slots” at their marginal opportunity costs, either by auctioning them or by varying take-off and landing fees so as to reflect the principles of peak responsibility pricing familiar to all students of utility regulation\(^4\)—the same principles that competition has forced the airlines to follow in pricing their services. At present, most airports still set their fees without differentiation between peak and off-peak, at levels intended merely to cover the historic costs of construction, and on the basis of the weight of the planes, both of which have very little to do with true economic costs. In consequence, private planes permitted to land at the highly congested Washington National Airport, for example, were still in 1987 paying landing fees of $2.75 to $8.00 per flight, using up slots whose value—i.e., opportunity cost—is almost certainly thousands of dollars. No wonder demand exceeds supply.

9. The monopoly returns from the suppression of competition under regulation showed up not in company profits—average returns on investment were chronically below the economy-wide average—but in egregiously inflated wages.\(^4\)\(^2\) The intense pressure of competition during the last decade has compressed them substantially. From the standpoint of the public welfare this had been an additional, substantial benefit of deregulation: monopoly wages are no more acceptable than monopoly profits.

At the same time, competition has brought insecurity and turmoil to the affected workers (but not unemployment in the aggregate; recall that

\(41\) See, e.g., supra note 16, at 89-103.

total employment has increased substantially). The resulting conflict—in many cases bitter and still unresolved—between labor and management, which may well have adversely affected the quality and perhaps even the safety of service.

These undeniable costs are part of the price we are usually willing to pay for the benefits of a competitive economy. The fact that they tend to be unusually severe during a transition from protectionism to a free market may just as logically be blamed on the regulation that created vested interests in its perpetuation as on the deregulation that dissolved them.

VII. COMPETITION IN SCHEDULING AND EXCESS CAPACITY

A. WAB:

Promise: Price competition would diminish the pressure for service rivalry “and would particularly eliminate scheduling pressure for excess capacity.”

Fact: Service and scheduling rivalry continues and “deregulation has actually increased the tendency for excess capacity.”

B. WAK:

Promise: Brenner has here subtly and illegitimately merged two separate expectations: the first, that the release of price competition would diminish cost-inflating service competition, including overscheduling; the other, that there was no reason to expect competition in a deregulated industry to be chronically destructive.

The facts:

1. As for the first of these “promises,” I have already alluded to the evidence, vindicating our predictions. Contrary to those of our opponents, load factors have been consistently higher than in the prederegulation years of the ’60s and ’70s, even during the most severe recession in 45 years, when, for the first time in history, the number of air travelers declined in absolute terms for two years in a row. I have alluded also to the widespread offering, since deregulation, of low-quality, low-price service options. The fact, cited by Brenner, that service and scheduling rivalry continues is neither a refutation of our predictions nor a defect in the industry’s performance. As we consistently observed, these are socially beneficial forms of competition, provided consumers are offered a sufficient choice among low and high price/quality options—which they

43. Brenner, supra note 3, at 201.
were not under regulation and are now.

2. As for the second "promise," I concede that the industry continues, in the face of poor financial results overall, to add to capacity. Its willingness to do so, however, whether or not rational, is a vindication of deregulation from the standpoint of the public, rather than a condemnation of it. The ultimate public concern about the possibility of destructive competition is that it may result in impairment of an industry's ability to finance needed expansions of capacity, and a consequent deterioration in the quality of the services it provides. Brenner's triumphant assertion, therefore, that carriers continue, perversely, to add to capacity is in effect a concession that this particular threat to the consumer has not materialized. One very important reason for this, of course, is that while the profit record of the industry as a whole has been poor, several of the airlines—American, Delta, USAir, Piedmont, Southwest, to take the most prominent examples—have been doing very well indeed.

VIII. DISRUPTION OF PREVIOUS SERVICE PATTERNS

A. WAB:

Promise: "the prior route network would continue to be served with little disruption."

Fact: "The turnover of routes has been massive."47

B. WAK:

Promise: As I have pointed out for decades (with a total lack of originality), any society that craves stability and predictability will opt for regulation and insulation from competition; a society that is willing to pay the price of instability in order to encourage creativity, innovation, and continuous improvement in productivity will opt for competition. This does not mean I expected large portions of the public to lose airline service; but no realistic advocate of deregulation could possibly have denied that it would

45. See infra at 247.
46. Why might competition prove to be excessive from the standpoint of the consumer?
   One possible reason is that the pressures of declining or inadequate revenues might force the curtailment of many postponable expenditures that the consumer would in the long run be better off having continued. . . .
   The decline in price to average variable costs can lead to a skimping on safety, reliability, and frequency of service that consumers may have difficulty in detecting promptly. The greater that difficulty, the greater the temptation of competitors to cut corners, since the competitor that skimps does not at once lose all his customers, while the one that scrupulously maintains quality may be inadequately rewarded for the higher costs of doing so.

Kahn, supra note 16, at 175-76.
47. Brenner, supra note 3, at 208.
introduce some uncertainty and instability.\textsuperscript{48}

The facts:

1. Thanks in important part to the Essential Air Services Program incorporated in the 1978 Deregulation Act, not a single community that enjoyed a minimum level of certificated service at the time of deregulation has lost it. Many communities have lost uncertificated—that is, unregulated—service since that date, just as many had lost it under regulation.\textsuperscript{49} But obviously that had little or nothing to do with either regulation before 1978 or deregulation since.\textsuperscript{50}

2. Considering the maniacally detailed restrictions on the operating authorities of airline companies under regulation, it would have been shocking if their removal had not resulted in a very substantial reordering of routes. Indeed, the more "massive" those changes (to use Brenner's adjective) the stronger the inference that the previous regulatory restrictions were grossly inefficient.

3. The statistics Brenner presents showing the very high percentage of nonstop routes dropped by the incumbent carriers between 1978 and 1983 (Figure 14) could equally well be interpreted therefore as evidence of the improvement in efficiency made possible by deregulation. In fact, the phenomenon disclosed by those figures was probably a reflection above all else of the widespread recourse to hub-and-spoke opera-

\textsuperscript{48} The virtues of the competitive market are many . . . . But these very virtues of competition are its defects from the regulatory standpoint. . . . Regulation necessarily places a high value on predictability and continuity. . . . Competition introduces strong elements of unpredictability—unpredictability about prices, instabilities of market shares. Industry planning is one thing, competition quite another, and there are strong incompatibilities between the two.

\textit{Id.} at 12-13.

This does not mean that I was neutral in the choice between the two systems:
Regulated monopoly is a very imperfect instrument for doing the world's work. It suffers from the evils of monopoly itself—the danger of exploitation, aggressively or by inertia, the absence of pervasive external restraints and stimuli to aggressive, efficient and innovative performance. Regulation itself tends inherently to be protective of monopoly, passive, negative, and unimaginative. . . . Regulation is ill-equipped to treat the more important aspects of performance—efficiency, service invocation, risk taking, and probing the elasticity of demand. Hence lies the great attraction of competition: it supplies the direct spur and the market test of performance.

\textit{Id.} at 325-26.

\textsuperscript{49} See, GAO, supra note 7c, at 29.

\textsuperscript{50} Of course, the removal of obstacles to entry elsewhere presented the previously unregulated carriers with new opportunities, which may have led to a diversion of their efforts from marginal to more attractive markets. As Brenner would be the first to proclaim (and lament), however, the industry's capacity is readily expansible. If unregulated carriers served communities before deregulation, it must have been because they found it profitable to do so. If they ceased to provide that service in order to take advantage of the new, more attractive opportunities for the use of their (in the short-run) fixed capacity, there is no reason why they would not have acquired additional capacity and continued to provide the previous service as well, so long as it continued to look profitable.
tions, the superior efficiency of which I have already explained. Moreover, the careful reader will already have observed, these statistics are suggestive only of changes in service, not losses: they tell us nothing about the extent—which we know was considerable—to which these (gross) cessations of nonstop service by incumbent carriers were followed by the provision of comparable service by others. And they totally ignore the considerable extent to which the replacement of both nonstop and multistop service by one-stop over a hub\(^\text{51}\) has made possible the greatly increased variety of destinations that, according to the authoritative study by Winston and Morrison, has been the principal source of the multi-billion dollar annual benefit the flying public owes to deregulation.\(^\text{52}\)

4. Another of Brenner's purported evidences of "massive disruption" is that the percentage share of the country's weekly flight departures has gone up at large and medium hubs and down for the nonhubs\(^\text{53}\). If I had just as many weekly departures today from my hometown airport as I had under regulation, I would properly be regarded as perverse if I though I had suffered a "massive disruption" of my service because departures from all the other airports in the country had increased, thereby reducing my percentage share. Yet those are the facts behind his percentages: according to his Figure 15, non-hubs have experienced practically no change in their average weekly departures between 1978 and 1987, while small hubs have enjoyed a 42 percent increase\(^\text{54}\).

51. See Strong, supra note 7a, at 120-21. In fact, Strong found that non-stop flights increased just as much as one-stop—both about 50 percent between December 1978 and December 1983—while three- to six-stop flights declined by 20 to 60 percent.
52. THE ECONOMIC EFFECTS OF AIRLINE Deregulation, 1986 BROOKINGS INST. 30.
54. The table shows that at the same time non-hubs experienced a 17 percent decrease in the number of weekly seats—obviously reflecting the more efficient adaptation of the type of equipment to market that was taking place before deregulation as well. The same observation applies to Brenner's implied criticism of deregulation for slowing down the rate of increase in the average size of aircraft:

Deregulation, with its emphasis on frequency and hubs, replaced previous fleet planning policies with a new emphasis on smaller aircraft.

This criticism simply ignores the superior convenience of improved frequency and the fact that the industry entered the deregulation era with a great surplus of wide-bodied aircraft. The competitive success of such carriers as USAir and Piedmont, was in large measure attributable to their use of smaller aircraft, to provide more convenient frequencies—a perfect example of the competitive market working more effectively than a regulated one.

It is an elementary economic principle that economic efficiency requires a balancing of minimum cost and optimum quality. We could conceivably maximize the "efficiency" of carrying people between Bozeman, Montana and Montgomery, Alabama, according to Brenner's implicit standard, by providing only wide-bodied jet service once every two weeks, thus forcing people traveling between those two points to plan their travel for the one day every two weeks when such a "most efficient" method of carriage was available to them; that would also, of course, minimize the pressure on airport capacity, which Brenner seems also to regard as an absolute desideratum. Id. at 211.
IX. THE FINANCIAL RESULTS

There is no denying that the profit record of the industry since 1978 has been dismal, that deregulation bears substantial responsibility, and that the proponents of deregulation did not anticipate such financial distress—either so intense or so long-continued. However:

1. Brenner’s figures are for net profits, i.e., return on equity. It is of some significance that the industry’s rate of return on annual total invested capital—interest on debt plus net profit after tax—has been no lower during the deregulation period than under regulation, as shown in the attached table.

55. See also Maldutis, supra note 5b. Winston & Morrison and Meyer & Oster both conclude that at least during the recession years 1981-82 the financial showing of the industry would have been even worse had it not been deregulated, because the benefits of their increased operating freedom outweighed the financial costs of intensified price competition. I do not have an independent judgment of this conclusion, but have no doubt either that, to take the extreme case, the very poor financial showing in 1986, a year of prosperity for the economy at large, must be attributed preponderantly to the intense price competition that deregulation permitted.

56. I do not presume to guarantee you that the industry will be a model of prosperity in the transition to a more intensely competitive regime. May I be permitted to whisper, however, that the industry’s financial record has not exactly been éclatant under the CAB’s protection? I cannot believe, in any event, that it requires governmentally-imposed cartelization to make this or any other industry creditworthy.

Kahn, supra note 4, at 28.

57. Since as the table shows, different groupings of years produce somewhat different results, it seems prudent to explain the particular ones I have selected:

1. The first, second and fourth groupings omit the results for 1978—the highest during the 22 years covered by the table—from both pre- and post-deregulation averages. The reason is not only that October of that year marked the passage of the Airline Deregulation Act, but that, as I have already observed, the CAB had during the 1976-78 period put into effect a very large number of the regulatory policies that were ultimately given the sanction of law in 1978. If anything, it would seem more logical to include 1978, therefore, in the post-deregulation years, thereby increasing the mean return during that period from 6.4 to 7.2 percent, as shown in the third line of the table.

2. The second and fourth groupings compare the results for the eight pre- and eight post-deregulation years. Since 1969 through 1973 were comparatively unprofitable, and 1965 and 1966 highly profitable years, the table presents also a prederegulation average for the entire 1965-1977 period: it comes to 6.3 percent, which is still slightly below the eight post-deregulation years, at 6.4 and even more below the 1978-86 period level of 7.2 percent. Incidentally, the fact that 1965 was a cyclical peak argues further against including the second cyclical peak year of 1978 in the pre-deregulation series, for comparative purposes.
TABLE 1

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2. Perhaps equally striking, deregulation evidently has not increased the volatility of these returns: as the table shows, their standard deviations have actually declined slightly. This showing is even more surprising than the level of investment returns, considering that the years since 1978 have been years of turbulent entry and exit, sharply declining concentration and then reconcentration of the industry, extreme differences in the costs of new entrants on one side and incumbents on the other—all of which have very substantially abated—and dramatic externally-imposed vicissitudes—the air controllers strike, the most severe recession in 45 years, and the explosion and subsequent partial recession of fuel prices.

3. What has deteriorated so dramatically, then, has been the industry’s rates of return on equity, as Brenner’s figures clearly show, reflecting the drastically increased cost of debt service. 58 I am not aware of any basis for choosing between these two measures of financial results as a general proposition. From the economic standpoint, it is the return on total investment, undistorted by differences in debt/equity ratios, that tends to be the more widely used in inter-industry comparisons. On the other hand, it would presumably be the return on equity that would best reflect the pressures on companies to cut costs—or, in the airline context, to cut corners on safety or service quality.

4. Average rates of return in the airline industry have been chronically low, both before and after deregulation. For example, the mean rate

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58. Calculations from the same source as Table 1 show an average industry net profit margin of 1.30 percent in 1970-77 and a puny 0.10 in 1979-86.

The post-deregulation record is heavily skewed by the crushing losses experienced by Pan American and Eastern Airlines: omission of these two raises the 1979-86 average to 0.77 and 1970-77 to 1.68. Inclusion of the very satisfactory 5.2 percent margin achieved in 1978 with the post-deregulation record further improves the picture, but a symmetrical inclusion of 1965-69 (when the simple average of yearly margins was 4.9 percent) would of course have the opposite effect, leaving the conclusion in the text unaltered.
of return on investment for all U.S. industries was 12.8 percent during the 1973-77 period (as compared with the airlines' 5.3 percent in 1970-77) and 13.0 in 1979-86 (as compared with the airlines' 6.4).59 The ultimate explanation—and it is more of a tautology than an explanation—seems to be the continuing willingness of investors to make capital available in adequate—indeed, by the test of comparative rates of return, excessive—quantities. So long as that continues—and prominent among Mr. Brenner's complaints is the continued willingness of the industry to expand capacity—the inability, predicted by opponents of deregulation, of a financially weakened industry to raise the capital required to provide satisfactory service has simply not appeared. One reason, as I have already suggested, is that these poor financial results for the industry as a whole, reflecting the turbulent process of weeding out high-cost and/or competitively weak firms, has not been incompatible with very satisfactory earnings by the leading survivors.

6. This last consideration returns us to the question of whether, as Brenner maintains, the multi-billion dollar annual savings to consumers will prove to have been a purely temporary benefit at the expense of profits and wages, and will ultimately disappear as the weeding out process is completed. To this there are two answers. First, these savings have come not at all from diminished returns on invested capital, as we have seen; partially from returns on equity and monopolistically high wages; but also largely from the substantial increase in efficiency that has been made possible by deregulation and compelled by competition. If the gain from unsustainably low returns on equity capital proves only temporary, there is no reason why the other sources will not persist as long as competition remains effective. Second, as I have already explained, there is no reason to believe that the oligopoly that emerges in this industry will be incompatible with effective competition—for many of the reasons that Brenner himself sets forth—any more than in a wide range of other unregulated industries. Finally, even if ultimately competition does prove to be inadequate, that does not prove it would have been wise social policy to have suppressed it through comprehensive regulation in the first place.

X. CONCLUSION

In framing its economic policies, a society's choices are, inevitably, among imperfect institutions. During the 1960s and 1970s there emerged something close to a consensus among disinterested students of the airline industry—among which I do not, of course, include spokesmen for the airlines themselves or their labor unions—that regulation had: denied

the traveling public the benefits of price competition; sheltered inefficiency; systematically encouraged competition in wasteful, cost-inflating ways; and encouraged the wage-price spiral that, in a broader context, might be conceived of as the microeconomic component of our national stagflation problem.

Deregulation and the competition it unleashed, however messy and imperfect, have brought the traveling public benefits worth billions of dollars a year, curbed and reversed the wage/price spiral, broken up institutional rigidities, and swept away legal and psychological barriers to productivity and innovation. It has been very hard on the industry itself; but it is the function of competition to be a hard taskmaster.

There have of course been severe problems and reasons for concern even from the public’s standpoint: most prominently sharply increased congestion and delays, increased concentration at hubs, monopolistic exploitation of a minority of customers, and possibly a narrowing of the margin of safety, even though actual accident rates have run consistently 35-40 percent below prederegulation levels. It seems absurd, however, even to consider returning to economic regulation in these circumstances, when the first and most logical way of confronting these problems would be for the government to fulfill responsibilities that we deregulators never intended it to abandon—responsibilities for intense surveillance of safety practices, adequate budgets and personnel for air traffic control, expansion of airport capacity to meet growing demands, efficient pricing of access to scarce airport facilities and airways, and vigorous enforcement of the antitrust and consumer protection laws. No sensible deregulator intended government to abandon these heavy responsibilities; on the contrary, we explicitly pointed out the necessity for increased effort and vigilance along all these lines even as we were freeing the industry—and its consumers—from the straightjacket of comprehensive cartelization.
Rejoinder to Comments by Alfred Kahn

MELVIN A. BRENNER

In his comments on my article, Dr. Kahn over-states the benefits of deregulation, under-states its problems, and ignores the many aspects of the deregulation rationale which have been proved fallacious by nine years of experience.

The principal benefit claimed for deregulation by Dr. Kahn is savings for the public, in the form of lower fares. He claims that these savings amount to $11 billion annually. That claim is totally lacking in credibility. To arrive at this $11 billion figure, Dr. Kahn assumed that—were it not for deregulation—improvement of fares would have come to an abrupt halt in 1976. This assumption enables him to credit to deregulation any improvement in fares that occurred after 1976. His approach is flawed on several grounds.

First, it creates an artificial birthday for deregulation—backdating it from 1978 (when the statute was enacted) to 1976. His rationale for this is that the CAB had started to liberalize certain policies at that time. However, anything that happened between 1976 and 1978 occurred under the regulatory statute—and merely shows that such statute was not a strait-jacket, but rather provided considerable policy latitude. The liberalization of some policies that occurred prior to 1978 was a far cry from the dismantling of the regulatory framework. It is merely a form of creative chronology to pretend that deregulation started two years before Congress acted.

Second, Kahn’s calculation implies that the level of fares in 1985 can be regarded as a viable, on-going fare level, when in fact it provided a
profit inadequate to cover interest payments. For adequate profitability, increased yields above the 1985 level would have been necessary—and, therefore, any fare savings calculated for the 1985 level would have to be considered temporary at best.

Third, in assuming that (without deregulation) fare improvement would have ceased in 1976, Kahn ignores the prolonged trend of declining fares that started long before deregulation. The accompanying chart (Figure 1) indicates the long-term nature of that trend, and the fact that the post-deregulation trend has essentially been just an extension of the previous trend line. This chart effectively refutes Kahn’s assumption that fares would have stopped improving in 1976, were it not for deregulation. Indeed, Kahn himself refers to the “very satisfactory decline in fares during the prederegulation decades.”

Why then does he assume that such decline would have halted in 1976? The only clue he gives is the statement that the prior trend was “primarily the contribution of technology.” The implication is that technology provided some fortuitous windfall, and that once that windfall ended, neither the carriers nor the CAB would have done anything on their own volition to continue any pattern of fare improvement.

The simple answer is provided by Kahn himself, in his text, The Economics of Regulation, where he stated: “The fact remains that technology does not develop unassisted by human hands, nor do the benefits of long-run decreasing costs fall as rain from heaven.” That comment is especially relevant to this industry. The tempo of airline technology has all along been driven by competitive and marketing pressures to acquire the most advanced equipment. There’s no reason to assume that those pressures would have ended in 1976.

But there is still another flaw in Dr. Kahn’s assumption. The trend of prederegulation fare improvement was also driven by a number of non-technological factors, all of which would have remained if there had been no deregulation. For example, airline marketers have aggressively pushed promotional pricing, to stimulate discretionary travel, for decades. Indeed, the Super Saver Fare of recent years (which Kahn seems to regard as some landmark in pricing) was basically patterned after the Discover America Fare, which preceded it by a decade, while the airlines were still regulated.

Additionally, Kahn’s implication ignores the intense, low-fare competition of charter services, which was encouraged by the CAB through steadily broadened operating authorization. He also ignores the effect of CAB actions in rate regulatory proceedings, which limited the costs that

could be passed on to the public, and kept billions of dollars out of the rate base.

From any standpoint, the suggestion that fares would have stood still in the absence of deregulation lacks foundation in the record, or in logic. The $11 billion claimed annual saving is statistical hyperbole. And without the "billions of dollars" of savings to repeatedly point to, the various problems of deregulation—some conceded by Kahn—lack the compensating offset he attributes to those alleged savings.

There are many other examples of error, inconsistency, or omission in Dr. Kahn's comments. The following illustrate some of them.

**Kahn Statement:** "In 1986, 90 percent of all passengers traveled on discount tickets, at an average discount of 61 percent below full coach fare. Clearly the benefits of price competition have therefore indeed been extremely widely distributed..." ¹²

**Comment:** Kahn equates a discount with a benefit—without considering the level of the full "list price" to which the discount is applied. By the fall of 1987, the average full fare level for airline travel had increased by over 150% since 1978—roughly double the rate of general CPI inflation.³ On some routes, the full fare has increased by 200% or 300% since 1978—treble or quadruple the rate of general inflation.⁴ A discount can be provided from such substantially escalated full-fare levels, and still not provide a real benefit. (On the Los Angeles-Sacramento route, for example, a seven-day advance purchase fare of $119 provides a 12% discount from the current full fare.⁵ But even that discounted fare represents 272% inflation above the unrestricted fare of 1978.)

In any case, the full effect of all 90% of the tickets sold at discount is incorporated into the fare trend data shown in Figure 6 of *Airline Deregulation—A Case Study in Public Policy Failure*,¹⁶ and all those discounts have done is merely bring the net average deregulated fare to a trend line similar to that already existing under regulation.

**Kahn Statement:** "The troublesome disparities that have emerged between fares in dense and in thin markets are not wholly discriminatory." ⁷

**Comment:** The cases of price disparity cited in my article did not relate solely to cases of "thin" vs. "dense" traffic routes. For example, the higher fare for Detroit-St. Louis vs. Detroit-Kansas City cannot be explained by traffic density. Interestingly, Dr. Kahn himself in a 1986 speech referred to "out-

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³ Speech by George James, President of Airline Economics Incorporated, to the Transportation Research Board (Jan. 11, 1988).
⁵ Information from airline telephone reservation system (Jan. 1988).
⁶ Brenner, supra note 4, at 196.
⁷ Kahn, supra note 2, at 237.
rageous examples of price discrimination. 8

*Kahn Statement:* "...there is no reason why, when United, Frontier, Continental and People Express became embroiled in intense price competition centered on Denver, US Air and Piedmont—both consistently extremely profitable carriers with the highest average yields per mile among the majors—should have been induced or required to compensate by increasing fares in their markets." 9

*Comment:* This statement is part of Dr. Kahn's denial that high fares in some markets have been subsidizing below-cost fares in others. His statement implies closed-off carrier systems, in which "intense price competition" exists only on some carriers' routes (e.g., United and Continental in his example), while other carriers (e.g., US Air and Piedmont) are immune therefrom. He states that "the identities of the airlines in the two categories of markets are not necessarily the same." Actually, of course, all major carriers have had a mix of different competitive situations. Even before People Express had brought its special brand of low-fare competition to Denver to impact United, it had brought it to Buffalo (to impact US Air), and to Norfolk (to impact Piedmont).

In view of Kahn's perception of US Air as a carrier unaffected by low-fare competition, he might find of interest the following example of price disparity within that carrier's system. In January 1988, US Air had an unrestricted one-way fare of $55 from Pittsburgh to New York, to meet competition on that route. Simultaneously, it charged $214 one-way from Pittsburgh to Chicago. The distances are similar (340 miles for the New York trip, 412 miles for the Chicago trip.) Both are high density routes, however, the fare to New York averaged 16 cents per mile, while the fare to Chicago was 52 cents per mile—more than 3 times higher. (Incidentally, the Chicago fare was 3 1/2 times above its 1978 level.)

*Kahn Statement:* "This is a ludicrously inadequate appraisal of a record of striking improvement in productivity and reduction in cost that can be attributed only to the undeniable increase in the intensity of competitive pressures on the carriers unleashed by deregulation and the freedom it conferred on them to control their own operations." 10

*Comment:* As in the discussion of pricing, Kahn has looked at certain improvements since deregulation, without checking back to see how these compare with trends previously existing. He refers to recent gains in productivity per employee. However, productivity gains in the decade before deregulation were similar (e.g., Figure 20 of Airline Deregulation—A Case Study in Public Policy Failure). 11

In any event, my article acknowledged that deregulation pressures have led to lower costs in various areas, including particularly wage rates and

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9. Kahn, supra note 2, at 238.
10. Id. at 240.
11. Brenner, supra note 4, at 221.
hence labor costs. But it also pointed out that there have been hidden costs associated with deregulation, and that it is not really clear what the overall net cost impact will be in the long run. Kahn does not comment on these hidden costs, with the one exception, noted immediately below.

Kahn Statement: "Brenner offers no support whatever for characterizing this change [toward smaller planes] as inefficient. . . ."  

Comment: This is a surprising statement, since I quoted Dr. Kahn himself on this subject. (". . . there are enormous economies associated with the size of plane, up to the limit of the biggest planes available."13). Indeed, even in his present comments, he again refers to the lesser cost-efficiency of smaller planes. ("It costs more per passenger to provide service on small planes . . ."). Evidently, Kahn wants to have it both ways. He wants to credit deregulation for the increased frequency afforded by the smaller planes—but is unwilling to admit that there is a price to be paid—i.e., the price in the higher seat-mile cost efficiency of such planes, and their greater contribution to airport congestion.

Kahn Statement: "...we could conceivably maximize the 'efficiency' of carrying people between Bozeman, Montana and Montgomery, Alabama, according to Brenner's implicit standard, by providing only wide-bodied jet service once every two weeks. . . ."14

Comment: If Kahn really believes that so far-fetched a conclusion flows from my "implicit standard", then he must accept it as flowing from his as well. As quoted above, he too has pointed out that larger planes are more cost-efficient than smaller ones. Obviously, however, it is a gross distortion to leap from that well-recognized fact, to the "straw man" of an absurd schedule from Bozeman to Montgomery.

Kahn Statement: "...it is irrational to conclude. . . that the anticipated effectiveness of contestability has therefore been disproved."15

Comment: By use of the double negative in this statement, Kahn leaves the reader with the impression that the concept of contestability is still alive and kicking. However, in an earlier footnote, Kahn mentions (but does not indicate the conclusions of) a recent article by Michael Levine in the Yale Journal of Regulation.16 Unless the reader goes to the trouble of getting a copy of that article, he'd have no way of knowing that it spent nearly 100 pages demonstrating that contestability has not worked. It is less than candid for Kahn to leave the impression that the contestability theory is still valid—while elsewhere mentioning (but not describing) an article that develops at great length the opposite conclusion.

Kahn Statement: "I have no recollection that in expressing the ex-

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15. Id. at 233.
pection that the possibility of entry would prevent grossly monopolistic exploitation, the advocates of deregulation clearly distinguished the roles they expected would be played, respectively, by totally new entrants and by existing carriers invading one another’s markets.” 17

Comment: Kahn is trying to downplay the significance of the diminished outlook for participation by “totally new entrants”. In fact, new entrants were deemed important enough to be given specific mention in the policy objectives of the Deregulation Act. (Those objectives included: “The encouragement of entry into air transportation markets by new air carriers. . . .”) It’s also worth noting that, in a 1986 speech, Dr. Kahn referred to the failure rate of new entrants as “frightening,” and also referred to the emerging “uncomfortably tight oligopoly” 18—concerns that find no echo in his present comments.

Kahn Statement: “The average number of carriers per route is apparently higher today than it was under regulation.” 19

Comment: The use of the word “apparently” is significant. His footnote indicates that the statement is based on evidence developed in 1984, and has not been brought up to date to take account of the wave of mergers between 1984 and 1987—mergers which have substantially changed this industry’s structure.

Kahn Statement: “They [the mergers] have also been permitted by a totally, and in my view indefensibly complaisant Department of Transportation. It is absurd to blame deregulation for this abysmal dereliction.” 20

Comment: By attempting to absolve deregulation, Kahn ignores the extent to which the deregulation advocates misjudged the matter of economy of scale in this industry. They proclaimed that such did not exist. When actual deregulation experience made clear that economy of scale does exist, industry consolidation became inevitable. The DOT’s merger approvals were merely bowing to a pragmatic reality, namely, that the more nearly comparable size of merged systems would permit more effective competition than would an attempt to force continuation of separate entities of widely disparate size.

Kahn Statement: “Contrary to those [predictions] of our opponents, load factors have been consistently higher than in the prederegulation years of the ‘60s and ‘70s. . . .” 21

Comment: This statement is an attempt to rebut my discussion of excess capacity. Kahn continues to ignore the reality of post-deregulation over-capacity, and to treat recent high load factors as a disclaimer of such over-capacity. Rather than repeat the discussion of this subject in my article, a simple answer to Dr. Kahn is provided by the following facts:

• In 1982, the industry’s load factor of 59% was 5.5 percentage points higher than the average for the 10 years preceding deregulation.

17. Kahn, supra note 2, at 233.
20. Id. at 234.
21. Id. at 244.
Yet, in that same year, the industry had an after-interest loss of over $2 billion.

And, in that year, one of Dr. Kahn’s co-sponsors of deregulation (Michael Levine) stated: “Excess capacity is the single most important threat to the financial health of the airline industry.” 22 If increased load factor had the significance attributed to it by Dr. Kahn, then there would have been no reason for Dr. Levine’s strong concern about over-capacity as the “single most important threat.” Nor would there be a reason (in 1987) for the First Boston Corporation to state: “Airlines have a chronic excess capacity problem.” 23

Kahn Statement: “Thanks in important part to the Essential Air Services Program incorporated in the 1978 Deregulation Act, not a single community that enjoyed a minimum level of certificated service at the time of deregulation has lost it.” 24

Comment: This statement, though accurate as far as it goes, is misleadingly incomplete. It fails to indicate that the Essential Air Services Program has been a temporary exception to free market concepts. It provides financial subsidy to assure continuation of service to small communities, and also stipulates that the last carrier in a given city cannot freely exit without government approval. The program was intended to be only transitional, and to expire in 1988. There is no present assurance as to what will happen to communities dependent upon this program, if and when it is indeed terminated, and the totally free market concepts of deregulation are left to apply to such communities.

Kahn Statement: “Any economist would recognize at once that filling seats at least some of which would otherwise be empty with fares that exceed marginal costs represents an unequivocal improvement in economic efficiency.” 25

Comment: The statement is dangerously wrong, and inadvertently embraces the very problem the industry has had with uneconomic pricing under deregulation. If a discounted fare exceeds just “marginal costs”, and if it is used (as stated by Kahn) to fill seats only some of which would otherwise be empty, it can be distinctly uneconomic. The missing element in the equation is what would have been paid for the seats which would have been occupied, even without the discount fare?

My article fully recognized the value of using a discounted fare to fill empty seats—but it went on to note the accompanying risk: “To the extent that it is used by passengers who otherwise would have been paying full fare, the discounted fare becomes a source of mere revenue dilution, rather than revenue generation.” Too often, the industry has fallen into the very trap held open for it in Kahn’s above-quoted doctrine. The logical desire to

24. Kahn, supra note 2, at 246.
25. id. at 242.
fill an empty seat has spilled over into excessive erosion of yield on existing traffic. And that is precisely why (since deregulation) the breakeven load factor has risen more than the actual load factor—and why the actual load factor, by itself, has become meaningless as a barometer of efficiency, or of financial health.

Kahn Statement: “The enormous response of travelers to the availability of these new [fare] options is a vindication of deregulation, not a condemnation of it.”

Comment: This reference to “enormous response” reflects the widespread impression that deregulation has stimulated a large surge of increased traffic. That is impression, not fact. Figure 9 of Airline Deregulation—A Case Study in Public Policy Failure indicates that the growth of traffic since deregulation has merely been in line with the growth trend of prior years.

Kahn Statement: “The ultimate public concern about the possibility of destructive competition is that it may result in an impairment in the ability of an industry to finance needed expansions of capacity, and a consequent deterioration in the quality of the services it provides.”

Comment: The above statement was made in connection with my claims that the industry has continued to engage in over-capacity. In this statement, Dr. Kahn suggests that if the carriers can continue to finance further additions to capacity, then there is no harm from the standpoint of the public. This overlooks the waste of valuable resources that is involved in the operation of excess capacity in this industry. In addition to the consumption of fuel, each unnecessary schedule places some extra load on the limited airport/airway capacity, and contributes to the congestion and delays the industry has been experiencing.

Kahn Statement: “There is no denying that the profit record of the industry since 1978 has been dismal, that deregulation bears substantial responsibility. . . .”

Comment: This admission is very much in line with my own comments on the financial record. However, Dr. Kahn then blurs the significance of this concession, with a red herring. He quickly shifts to a two-page discussion of “rate of return on annual total invested capital—interest on debt plus net profit after tax.” He points out that this measure “has been no lower during the deregulation period than under regulation. . . .”

In the context of what has happened to this industry, that is a meaningless statement. As indicated, this measure includes (without differentiation) the profits from operations, and the interest paid out to creditors. Both are considered as part of the “return”. A carrier can be incurring sizeable losses, be on the verge of bankruptcy—and still it could show a favorable “rate of return”, because the very interest payments that are threatening its solvency, would be counted as part of that return.

26. Id. at 242.
27. Brenner, supra note 4, at 200.
28. Kahn, supra note 2, at 245.
29. Id. at 247.
A before-and-after comparison of rate of return *might* be relevant if the relationship of interest payments to profits had not changed. But they have changed radically. In the eight years before deregulation, aggregate industry interest payments were some 40% less than operating profits. In contrast, in the first eight years after deregulation, interest payments have been more than *two and a half times larger* than aggregate profits. When there has been so drastic a change in the interest component of "rate of return", it is a bit disingenuous to attribute significance to a before-and-after comparison of such rate of return.

**Kahn Statement:** "I will make no effort systematically to appraise the fairness with which he [Brenner] has characterized the *expectations* (or 'promises') of the proponents of deregulation about how it would work out..."\(^{30}\)

**Comment:** Kahn thus seeks to dismiss (rather than discuss) the attention given in my article to the underlying theories advanced in support of deregulation. My article quoted the statements of deregulation advocates on such basic issues as: cross-subsidy; economies of scale; ability of new entrants to compete with established carriers; market contestability; relationship of price competition to service rivalry; causes of airline overcapacity. I indicated how and why the deregulators' position on such issues failed to consider the realities of airline marketing.

These were not peripheral questions, but instead went to the very heart of deregulation rationale. Because of the fallacious reasoning on these issues, deregulation doctrine rested on quicksand, and the new regime could not work out as promised.

If my quotations from deregulators' statements had been inaccurate, or taken out of context, it would have been a simple matter for Dr. Kahn to cite specific examples. It is a lame excuse for him to opt out of discussing these aspects of deregulation theology, by claiming that it would have required a "massive effort" to do so.

\(^{30}\) *Id.* at 230.
The Competitive Access Debate: A "Backdoor" Approach to Rate Regulation

G. KENT WOODMAN*
JANE SUTTER STARKE**

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I. INTRODUCTION

The past decade has been a time of dramatic change in the transportation business in this country; change that had its genesis in the enactment by the Congress of major legislation deregulating the trucking, airline, and railroad industries.\(^1\) In each case, Congress followed the clear public policy of replacing the heavy hand of Federal economic regulation with the invisible hand of the free market. Rather than ongoing Government involvement in the transportation economy, Congress determined that rates and prices for transportation should be set in the marketplace, with the Government role limited to approving specific transactions and remedying anticompetitive behavior.\(^2\)

Since economic regulation was for much of this century an integral part of the transportation industry, it is not surprising that this fundamental change generated considerable controversy and debate, both during consideration of the three legislative proposals and in their subsequent implementation. Now, the passage of time has provided some perspective from which to consider the effects of deregulation and to analyze both

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The purpose of this article is to examine railroad deregulation by reviewing the regulatory system of the pre-Staggers era, the reforms of the Staggers Act and its implementation, and the recent legislative efforts to reregulate the rail industry.

II. BACKGROUND: THE PRE-STAGGERS ERA

To evaluate fairly the public policy merits of the current debate over the deregulation of the rail industry, it is necessary to first look back to the pre-Staggers Act era, when the industry was characterized by a lack of price competition among carriers, practices of rate equalization and open routing, and heavy regulatory intrusion by the Federal Government into almost all aspects of the rail business. This combination of factors created an economic and operational climate that contributed to the bankruptcy of several major railroads and threatened the financial stability of the entire national rail system.

The system of Federal rail regulation was in effect for more than 80 years and at its height was both pervasive and complex. The system was one of near total rate regulation, with the Interstate Commerce Commission ("Commission") exercising significant control over the rates railroads charged their customers. Moreover, the system was incredibly overburdened. There were literally millions of different rates published and on file with the Commission.

One of the significant features of the regulatory system that is particularly relevant to today’s debate is the concept of rate equalization and open routing. "Rate equalization" meant that the same rate applied equally on all routes between a particular origin and destination over which the traffic could possibly move. For example, if there were 50 routes between Atlanta and Cincinnati, rail transportation over those routes was offered to shippers at the exact same rate, without regard to the actual cost of providing the service. This rate equalization extended both to single line rates, where only one carrier was involved in the movement, and to joint rates, where two or more carriers were involved in the movement over a "through route" at a single published rate (with each participating carrier receiving a "division" of the published rate).

"Open routing" was a practice whereby through routes were required to be made available on practically all possible combinations of
railroad tracks between a particular origin and destination, regardless of efficiency or associated cost.

In the pre-Staggers era, most intercity traffic was subject to joint rates. Many joint rates were established in rate-making cartels, called rate bureaus, which had a statutory immunity from the antitrust laws. Once a joint rate was established, changes in that rate or in its divisions could occur only with the concurrence of all participating carriers or pursuant to a lengthy proceeding before the Commission.

During this era, the Commission played a vigilant role in maintaining the policies of rate equalization and open routing. The Commission used its authority under 49 U.S.C. § 10705 to prescribe and maintain joint rates and through routes. Under this provision, the Commission has the authority to require a rail carrier to enter into joint rates and through routes whenever "desirable in the public interest," and to suspend proposed joint rate and route cancellations whenever not "consistent with the public interest." In addition, the Commission until recent years required the consolidated carrier in a rail merger to keep open all existing through routes, even though that carrier could provide single line service as a result of the merger. Finally, the Commission used what was known as the "commercial closing doctrine" to prevent a rail carrier from lowering its rates on a particular route on the theory that such rate reduction would effectively "close" all the higher-priced routes between the same points.

In essence, what existed in the pre-Staggers era was a regulatory system that precluded rate competition among rail carriers, because all rates between a particular origin and destination were the same on all routes. There were two devastating effects of this system. First, joint rates were typically set at levels that protected the least efficient carriers and routes; rail carriers with more efficient routes and the capacity to offer lower rates were precluded from offering those rates. One result of this was that rail rates were not competitive with other, less regulated modes of transportation, such as trucks and barges, and the rail industry lost significant market share to those other modes. Second, the joint rate system and the extreme difficulty of increasing divisions frequently resulted in rail carriers participating in joint movements that did not cover their variable costs or provide a fair return. This in turn greatly restricted the ability of carriers to attract the capital necessary to maintain and revitalize existing rail plant and equipment.

Some statistics serve to illustrate the harmful effects of this regulatory system. First, the decline in market share experienced by the rail industry

6. These requirements were known as the "DT & I Conditions."
was staggering. Railroads carried twice as much in intercity ton miles of freight in 1947 as they did in 1979. In 1947, railroads carried 3 times as much traffic as trucks; by 1979, trucks were carrying 50 percent more tonnage.\(^7\) A comparison of Census of Transportation data for 1963 and 1972 shows a decline in rail market share over the period in chemical traffic, machinery, meat and dairy products, and almost every other commodity group.\(^8\) In many cases, the rail market share in 1972 was slightly more than one-half of what it was in 1963. Across the board, railroads were locked in a regulatory straightjacket that prevented them from competing effectively with trucks and barges. This was a disastrous situation for the rail industry in particular and the Nation’s transportation system in general.

Second, the rail industry presented a dismal picture in the late 1970’s in terms of return on investment and ability to attract capital. The rate of return on investment between 1966 and 1979 was never more than 3 percent.\(^9\) The rail industry rate of return on equity was 1.55 percent in 1978, compared to a rate of 8.6 percent for barges and 17.2 percent for trucks.\(^10\) The rail industry rate of return on net worth was 1.3 percent in 1978, compared to a total manufacturing rate of 15.9 percent, a rate of 12 percent for public utilities, and a rate of 8.2 percent for all transportation.\(^11\)

This problem was compounded by the enormous capital needs and the severe capital shortfall of the rail industry. In 1978, the Department of Transportation issued a report estimating that between 1976 and 1985 the industry would have a capital shortfall of between $13.1 and $16.2 billion.\(^12\)

Finally, the problems created by extensive rail regulation were not placed exclusively on the carriers; shippers dependent on rail transportation were also unable to take advantage of the benefits of competition and a free market. For example, due to rate equalization, shippers that used an efficient single line route could not receive the lower rates that would have been available in a deregulated environment. Further, shippers

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8. Id. at 38. For chemical traffic, railroads hauled 62 percent of the ton miles in 1963 but only 44 percent in 1972. For machinery, railroads hauled 52 percent of the ton miles in 1963 but only 38 percent in 1972. For meat and dairy products, the rail ton mile haul was 47 percent in 1963 and dropped to 28 percent in 1972.
9. Id. at 35.
10. Id. at 36.
11. Id. at 98.
could not negotiate and enter into contracts with railroads, and therefore could not benefit from the inherent rate reductions that accompany long term commitments of traffic. Finally, the ultimate harm to shippers was the deterioration or loss of service resulting from the extreme financial distress of the rail carriers.

To conclude, it is not an overstatement to say that this archaic Federal regulatory structure played a major role in the ultimate financial collapse in the 1970's of a significant portion of the rail industry in the United States. In the Northeast, seven railroads filed for bankruptcy, including many giants of a once proud industry—the Penn Central, the Erie Lackawanna, the Reading, the Lehigh Valley, the Central of New Jersey, the Lehigh & Hudson River, and the Ann Arbor. The demise of these carriers created a transportation crisis in the northeast and midwest, and raised the specter of significant American industries being left with no rail transportation. The severity of the problem caused the Congress to create Conrail out of the ashes of the bankrupt carriers and to spend over $7 billion to restore life to the northeast freight rail system. In the midwest, two major carriers, the Milwaukee Railroad and the Rock Island, also fell victim to bankruptcy, creating the need for further Federal Government intervention and financial support.\(^\text{13}\)

This financial crisis had an additional critical affect at the Federal level: it forced Congress to take a hard look at the system of rail regulation, and to take dramatic steps toward the deregulation of the rail industry, beginning with the enactment of the Railroad Revitalization and Regulatory Reform Act of 1976\(^\text{14}\) ("4R Act") and culminating in the Staggers Rail Act of 1980\(^\text{15}\) ("Staggers Act").

### III. REFORMS OF THE STAGGERS ACT

**A. THE BASIC PRINCIPLES**

The Staggers Rail Act of 1980 was designed to complete the deregulatory efforts that began with the 4R Act and to consummate a dramatic shift in both Government regulatory policies and the rail industry's freedom to operate in the marketplace. The key policies of the Staggers Act, as stated in the new Rail Transportation Policy, were "to minimize the need for Federal regulatory control over the rail transportation system" and "to allow, to the maximum extent possible, competition and the de-


mand for services to establish reasonable rates.'\textsuperscript{16}

The cornerstone of these efforts was the deregulation of railroad rates. Under the Staggers Act, rail carriers are permitted to establish rates free from Government regulation unless the carrier has market dominance over the transportation.\textsuperscript{17} If market dominance exists, then the rate must be reasonable, and the Commission has jurisdiction to determine reasonableness.\textsuperscript{18} The economic model that served as the underpinning for the Staggers Act is that competition and market forces, in most cases, can be relied upon to establish reasonable rates; but where competition and market forces are absent, the Government has a regulatory role to assure that rates are reasonable.

By allowing competition and the demand for services to establish rates, the Staggers Act took a giant step toward dismantling the rate equalization system described above and all its inherent inefficiencies. In addition, Congress in the Staggers Act recognized the debilitating impact on the industry's financial health of "the proliferation of uneconomic routes"\textsuperscript{19} under the existing joint rate system, and specifically provided rail carriers with additional joint rate cancellation and surcharge flexibility.\textsuperscript{20} The new joint rate provisions were designed to assure that carriers participating in a joint rate would either be able to earn revenues equal or greater than 110 percent of variable costs or to close routes that were not providing this level of earnings.\textsuperscript{21} After the enactment of the Staggers Act, many carriers used their new found authority of cancellation and surcharges to free themselves from noncompensatory joint rates.

A further significant advance made by the Staggers Act was the codification of the right of rail carriers and shippers to enter into contracts.\textsuperscript{22} The contract provision was viewed as serving the interests of both rail carriers and shippers by reducing uncertainty about long term market and service conditions.\textsuperscript{23} The Congress considered the establishment of contract rates to be a "significant aspect of the new freedom allowed rail carriers to market rail transportation more effectively,"\textsuperscript{24} and accordingly

\begin{itemize}
\item \textsuperscript{16} See 49 U.S.C. § 10101(a)(1)-(2) (1982).
\item \textsuperscript{17} See 49 U.S.C. § 10709(a) (1982).
\item \textsuperscript{18} See 49 U.S.C. § 10701(a) (1982).
\item \textsuperscript{20} See 49 U.S.C. § 10705(a) (1982).
\item \textsuperscript{21} CONFERENCE REPORT, supra note 19, at 111, 112.
\item \textsuperscript{22} See 49 U.S.C. § 10713 (1982). Prior to the Staggers Act, contracts had been permitted on a limited basis by a November, 1979 decision of the Commission. This Commission decision, however, had a number of restrictions and uncertainties and had not been widely relied upon to any great extent.
\item \textsuperscript{23} HOUSE REPORT, supra note 7, at 57.
\item \textsuperscript{24} CONFERENCE REPORT, supra note 19, at 100.
\end{itemize}
intentionally limited the Commission’s jurisdiction for disapproving contracts.

Taken together, the significant deregulation of rail rates, the new flexibility of carriers to escape uneconomic joint rates and routes, and the ability to negotiate and enter into contracts effectively removed the heavy cloak of Government regulation and rate equalization that had brought the industry to near financial collapse. In combination, these reforms altered the very nature of the rail industry and gave new economic life to the railroads.

B. THE BENEFITS TO SHIPPERS

The flexibility afforded carriers under the Staggers Act to adjust rates in response to market demands, to cancel inefficient through routes, and to enter into contracts has also had significant economic benefits on the shipping community. In the 1981 to 1986 period following enactment of the Staggers Act, rail rates decreased in constant dollar terms by 5.1 percent. Coal rates dropped almost 5 percent over the last two years, and are now at their lowest point since 1981. Average grain rates decreased 12 percent over the last two years and plummeted 28 percent since 1980.

The ability to enter into contracts accounts for the significant decline in grain rates. A recent Commission report to Congress estimates that 63 percent of all grain tonnage moves under contract. The market for grain transportation is shared to a surprisingly large extent with other transportation modes. In fact, the Commission’s report identified that in 1985 60 percent of all grain moved via truck or barge, an indication that the rail industry faces stiff competition in competing for grain traffic. Contracting has enabled carriers and grain shippers to establish terms and conditions of rail service based on mutual agreement rather than regulatory intervention. As a result, carriers are in a better position to offer competitive rail rates to shippers. This is indeed true for the transportation by rail of other commodities as well.

The Staggers Act has also had a marked effect on rail carriers’ earnings and ability to reinvest in their systems. Deferred maintenance is no longer a problem, with capital investment totalling almost $8 billion since

29. Id. at 3.
1980.\textsuperscript{30} As a result, carriers are able to provide efficient, reliable, and high-quality service to shippers. Yet, despite an increase in earnings, the railroads' return on net investment has been modest, indicating that competitive pressures have held down rail rates.\textsuperscript{31}

\textbf{C. THE EMERGING DEBATE: COMPETITIVE ACCESS}

Most of the debate regarding railroad deregulation, both during the consideration of the Staggers Act and in the following years, has centered around the issues of rate reasonableness, market dominance, and revenue adequacy. However, considerable attention has been paid of late to the concept of "competitive access," which has been defined as the availability of facilities owned by one rail carrier for services provided by or in conjunction with another rail carrier.\textsuperscript{32} However, as envisioned by the reregulation forces, this "availability" is not obtained pursuant to an agreement reached in the market by willing parties, but rather is a remedy imposed by the Commission.

As the term has come to be understood, competitive access includes three separate concepts: the prescription of joint rates, the granting of terminal tracking rights, and the granting of reciprocal switching rights.\textsuperscript{33}

\textbf{1. JOINT RATES}

The Commission has the authority under 49 U.S.C. § 10705 to prescribe joint rates and through routes when "it considers it desirable in the public interest." As discussed above, in the pre-Staggers era the joint rate provisions were used by the Commission primarily as a means for insuring rate equalization and open routing. After the Staggers Act and its greater freedom to cancel joint rates and impose surcharges, these provisions have taken on a new and different role as a device for rail carriers or shippers to force a new entrant into a particular transportation market through the prescription of joint rates. Although the statutory standard for prescription remains the test of "desirable in the public interest," the Commission has articulated a more detailed analytic framework in its Intramodal Rail Competition regulations, discussed \textit{infra}.


\textsuperscript{31} In the one year period ending June 30, 1987, the carriers' return on net investment was 2.89%, despite record gains in traffic. \textit{On Track, A Railroad Industry Report}, Vol. 1, No. 21 (December 1-31, 1987) at 1.


\textsuperscript{33} Although all three matters are dealt with here in the context of the Staggers Act, only reciprocal switching and joint rates were actually included in that Act. Terminal facilities had an earlier origin in the Interstate Commerce Act.
2. **TERMINAL FACILITIES**

The Commission has the authority, under 49 U.S.C. § 11103 to require terminal facilities owned by one rail carrier to be used by another rail carrier if the Commission finds that use "to be practicable and in the public interest without substantially impairing the ability of the carrier owning the facilities or entitled to use the facilities to handle its own business." The access to terminal facilities may include access to main line tracks for a reasonable distance outside of the terminal.

Primary responsibility for establishing the conditions and compensation for use of the facilities involved rests with the carriers, but if they are unable to agree the Commission may establish those terms under the principles controlling compensation in condemnation proceedings.

3. **RECIPROCAL SWITCHING**

The Staggers Act added new language to 49 U.S.C. § 11103 granting the Commission the authority to require rail carriers to enter into reciprocal switching agreements where "it finds such agreements to be practicable and in the public interest, or where such agreements are necessary to provide competitive rail service."

Similar to the terminal access provision, the carriers involved in reciprocal switching are responsible for establishing the switching terms and conditions, but the Commission may act if the parties are unable to agree.

This provision was included in the Staggers Act because while the Commission clearly had the power to order joint use of terminal facilities, its power to order reciprocal switching was "less clear."34 The legislative history indicates the standard to be used by the Commission for reciprocal switching was the same as that applied in determining whether to order joint use of terminal facilities.35 The Conference Report accompanying the Staggers Act, in discussing this provision, noted that "in areas where reciprocal switching is feasible, it provides an avenue of relief for shippers where only one railroad provides service and it is inadequate."36

Considering these three competitive access provisions in the context of the Staggers Act, it is clear that they were essentially unconnected to the issue of rail rates. The question of rates was addressed through the concepts of market dominance and rate reasonableness. These access provisions were, on the other hand, more in the nature of "housekeeping" tools available for improving service to shippers and preserving

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34. See House Report, supra note 7, at 67.
36. Emphasis added. Id.
competition. It is simply inconsistent with the overall statutory scheme of the Staggers Act and its legislative history to utilize these access provisions as a "backdoor" means for the regulation of rail rates. Yet, there is little question that stripped of the rhetoric, the ultimate goal of the so-called Consumers United For Rail Equity (CURE) group and other re-regulation forces is to lower rail rates, and as discussed infra, they are quite willing to engage in whatever statutory contortions may be necessary regarding the competitive access provisions in order to achieve that end.

IV. THE IMPLEMENTATION OF STAGGERS: ACTIONS OF THE COMMISSION

A. COMPETITIVE ACCESS REGULATIONS

In October 1985 the Commission adopted regulations to govern competitive access determinations. These regulations developed from an agreement entered into between the Association of American Railroads (AAR), the National Industrial Transportation League (NIT League), and the Chemical Manufacturers Association (CMA). This joint proposal was presented to the Commission in a petition for rulemaking. The regulations ultimately issued made some modifications to the joint proposal, based in part on a proposal submitted by a coalition of smaller carriers known as Railroads Against Monopoly (RAM), but the regulations largely reflect the consensus reached between the parties. The rulemaking proceeding constituted a deliberate effort by the Commission to achieve "cooperation and consensus among the contending parties to the maximum extent possible." The regulations were recently upheld on appeal to the United States Court of Appeals for D.C.Circuit in Baltimore Gas and Electric Company v. United States.

The regulations are designed to "facilitate efforts to ensure reasonable competitive access where needed"—giving shippers "more routing alternatives, while at the same time promoting competition among railroads." The regulations impose new procedures for the cancellation of a through route or joint rate and set substantive standards for assessing cancellations, as well as for prescribing or establishing a through route or joint rate and reciprocal switching agreements. The regulations do not, however, address the issue of the granting of terminal trackage rights, based on the Commission's judgment that such rights are rarely sought

37. The CURE group is a coalition largely composed of utilities and coal companies, but also includes Consumer Federation of America and some chemical and agricultural concerns.

38. Ex Parte No. 445 (Sub-No. 1), Intramodal Rail Competition, 49 C.F.R. § 1144.1-1144.6 (October 29, 1985).

39. id. at 2.

40. 817 F.2d 108 (D.C. Cir. 1987).

41. Ex Parte No. 445 (Sub-No. 1), supra note 38, at 15.
and that the regulations are sufficient to provide ample competitive access through joint rates, through routes, and reciprocal switching where necessary. The Commission preferred to consider such terminal track-age rights requests on a case by case basis using existing law.\textsuperscript{42}

1. CANCELLATIONS: NOTIFICATIONS, EXPLANATION, AND JUSTIFICATION

Section 1144.1 of the regulations requires carriers to give 45 days notice of a proposed cancellation of a joint rate or through route. "Any affected party" may ask the carrier for an explanation of the effect of the cancellation on that party and, if the route or rate is actively used or participated in by that party, a justification for the cancellation. The requested information, including pertinent mileage and cost data, must be supplied within 10 days of the request, unless an alternate time period is mutually agreed to by the parties. The regulations specifically provide that a failure to provide information necessary to determine if the proposed cancellation meets the criteria for suspension and/or investigation of the cancellation may be treated as an admission against interest.

2. CANCELLATION AND PRESCRIPTION: NEGOTIATION

A party that intends either to challenge a cancellation of a joint rate or through route or to seek the prescription of a joint rate, through route, or reciprocal switching agreement must attempt to engage in negotiations to resolve the dispute. However, the regulations provide that a failure to participate in negotiations does not waive the party's right to seek further remedies either contesting the action or seeking affirmative relief. Arbitration of the dispute is specifically referenced as an alternative for dispute resolution, in lieu of adjudication of the dispute before the Commission.

As described by the Commission, the provisions for explanation, justification, and negotiation afford sufficient notice of a proposed cancellation to allow shippers and carriers to assess the impact of the cancellation and to take action to protect their interests.\textsuperscript{43} The provisions are designed to promote cooperation and, to the extent parties are able to work together, minimize the need for the Commission's regulatory control.\textsuperscript{44}

3. CANCELLATION: STANDARDS FOR SUSPENSION

The Commission is empowered to suspend a proposed cancellation of a joint rate or through route under 49 U.S.C. § 10707(c)(1). Suspension of a cancellation is temporary in nature, lasting only until the Comm-

\textsuperscript{42} See 49 U.S.C. § 11103(a) (1982).
\textsuperscript{43} Ex Parte No. 445 (Sub-No. 1), supra note 38, at 3.
\textsuperscript{44} Id. at 4.
mission makes a determination of whether the cancellation is lawful. In that sense, suspension is similar to a temporary restraining order or preliminary injunction, with the review on the merits occurring in the subsequent determination of the "lawfulness" of the cancellation.

Section 10707(c)(1) of Title 49 sets forth the factors that must be met in order for a suspension to be granted. These factors are:

(1) it is "substantially likely" that the protesting party will prevail on the merits; and

(2) without suspension, the proposed rate change will cause substantial injury.

Specific criteria are included in section 1144.3(c) of the regulations to be used in determining whether the above factors have been met. If some but not necessarily all of these criteria are satisfied, the Commission may opt not to suspend the cancellation but still initiate an investigation, or note to investigate at all. If all the criteria are met, the Commission must suspend the cancellation of a joint rate and through route and investigate the lawfulness of the cancellation. The criteria require a showing by the protesting party that:

(1) the cancellation would eliminate effective railroad competition for the affected traffic. In considering this criterion a rebuttable presumption demonstrating the elimination of effective railroad competition can be raised based on evidence showing either: (a) the mileage on the route to be cancelled is not more than that on a feasible alternative rail route; or (b) the cost of operating on the route to be cancelled is not more than that of any feasible alternative rail route; and

(2) the protesting shipper (or carrier) has used or would use the route or rate to meet a significant portion of its current or future transportation needs (or for purposes of a carrier, a significant amount of traffic).45

The Commission considered suspensions to be appropriate in cases in which the above criteria are demonstrated because, in the absence of suspension, shippers or carriers in those cases would face rate increases or reductions in service which could lead to a loss of traffic and injury to their business during the Commission proceeding to determine the lawfulness of the cancellation.46 The Commission found suspension to be justified in these cases in order to guard against this harm—a harm which cannot be easily remedied by refunds or future access.47

The presumption created was proposed by RAM and adopted by the Commission to give "protestants added protection by reducing the evidentiary burden on them."48

45. Id.
46. Id.
47. See Ex Parte No. 445 (Sub-No. 1), supra note 38, at 4.
48. Id. at 6.
4. **Cancellation: Investigations**

The statutory standard governing the determination of whether a proposed cancellation of a joint rate or through route is lawful is whether it is "consistent with the public interest." The Commission's regulations specify that a cancellation of a joint rate or through route will be adjudged to be contrary to the public interest if it is contrary to the competition policies of 49 U.S.C. § 10101(a) or is otherwise anticompetitive. The Commission will consider "all relevant factors" in making this determination, including:

1. the revenues of the railroads involved generated by the affected traffic and route;
2. the efficiency of the route and its costs of operation;
3. the rates charged or sought to be charged; and
4. the revenues, post-cancellation, and costs of the affected traffic and route; the ratios of those revenues and costs; and circumstances relevant to any difference in those ratios. (A proviso is included which states that a mere loss of revenue to an affected carrier does not suffice as a basis for finding that a cancellation is anticompetitive.)

The regulations specifically exclude any consideration of product competition in determining whether a cancellation is anticompetitive. Product competition is generally regarded as the competition presented by the availability of product that can be substituted for the product presently being shipped to the receiver. This form of competition is typically included in a determination of the competitiveness of a given market. Product competition is examined in a market dominance proceeding since it is a significant factor which affects the railroad's ability to price its services and set rates. However, the Commission appeared to defer to the parties' agreement, which excluded consideration of product competition. In justifying exclusion, the Commission also commented that product competition is typically a "less direct" form of competition with a more tangential nexus to the injury complained of, and is less relevant in determining whether another carrier should have access to the shipper transporting the "primary" product. Moreover, the Commission found that, as compared to other forms of competition, product competition tends to be more difficult to demonstrate and the least often shown to be an effec-

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50. See Ex Parte No. 445 (Sub-No. 1), supra note 38, at 6-7.
51. See Ex Parte No. 445 (Sub-No. 1), supra note 38, Commissioner Strenio, Commenting. Commissioner Strenio is of the opinion that it is unsound policy to refuse to consider evidence on product competition that is relevant. Further, any shipper concerns regarding proof of product competition could have been addressed by shifting that burden to the railroads, as was done for purposes of geographic competition, according to the Commissioner. Andrew J. Strenio, Jr., Preserving Rail Regulatory Reform, 1 Regulatory Reform Issue 3, n.4.
52. Ex Parte No. 445 (Sub-No. 1), supra note 38, at 8.
five constraint on rates.\textsuperscript{53}

However, the regulations provide that geographic competition will be considered in the Commission’s competitive analysis. Geographic competition is generally regarded as that competition presented by the existence of a different source for the same product. However, the burden of proof on geographic competition determinations is on the rail carrier and must be demonstrated by “clear and convincing evidence”—a higher level of proof than is typically used in Commission proceedings. This treatment of geographic competition is consistent with the Commission’s market dominance guidelines.\textsuperscript{54}

Finally, the regulations provide that if a cancellation is shown to be anticompetitive, the “revenue inadequacy” of a carrier cannot be used to justify the cancellation. Revenue adequacy is an important concept in the statutory and regulatory framework that governs the rail industry, as part of the overall goal of improving the financial health of rail carriers.\textsuperscript{55} Consequently, revenue adequacy is used in the determination of the reasonableness of rail rates.\textsuperscript{56} However, in the context of competitive access, the regulations make clear that revenue inadequacy is not justification for an anticompetitive cancellation of a joint rate or through route. The Commission noted that this is consistent with the language of 49 U.S.C. § 10705(a)(3), which provides that the Commission may not prescribe a joint rate or through route to assist a participating carrier to meet its financial needs.\textsuperscript{57}

5. \textit{Prescription: Standards}

The Commission has the authority to prescribe joint rates and through routes when it considers that action “desirable in the public interest.”\textsuperscript{58} Similarly, the Commission may require rail carriers to enter into reciprocal switching agreements if such agreements are “practicable and in the public interest, or where such agreements are necessary to provide competitive rail service.”\textsuperscript{59} The Commission’s regulations require a rate,

\textsuperscript{53} Id.
\textsuperscript{54} See, id. at 7, n.6, citing Ex Parte No. 320 (Sub-No. 3).
\textsuperscript{55} 49 U.S.C. § 10101(a) (1982), which sets forth the Rail Transportation Policy, states that in regulating the railroad industry, among other items, it is the national policy to “promote a safe and efficient rail transportation system by allowing rail carriers to earn adequate revenues, as determined by the Interstate Commerce Commission.” See also, Staggers Rail Act of 1980, Pub. L. No. 96-448, § 3, 94 Stat. 1895, 1897 (1980), which states that the purpose of the Act is to provide for the restoration, maintenance, and improvement of the physical facilities and financial stability of the rail system.
\textsuperscript{57} Ex Parte No. 445 (Sub-No. 1), supra note 38, at 7.
route, or agreement to be prescribed or established if two criteria are met:

1. the prescription or establishment is necessary to remedy or prevent an act that is contrary to the competition policies of 49 U.S.C. § 10101(a) or is otherwise anticompetitive (and otherwise satisfies the statutory criteria described above); and

2. the protesting shipper (or rail carrier) has or would use the rate, route or agreement to meet a significant portion of its current or future rail transportation needs (or, in the context of a rail carrier, for a significant amount of traffic). 60

"Relevant factors," including cost and revenue information similar to that delineated in the investigation section, 61 are required to be considered by the Commission in determining whether prescription is necessary to remedy or prevent an anticompetitive act. Other enumerated considerations track those included for investigation of cancellations of joint rates and through routes: eliminating the consideration of product competition; switching and increasing the burden of proof regarding geographic competition; and eliminating revenue inadequacy as a basis for denying a prescription.

B. MIDTEC

Great attention has been focused by the proponents of deregulation on the Midtec proceeding before the Commission. 62 The prolonged nature of that proceeding was created in part by the fact that the Commission was concurrently working on its Intramodal Rail Competition regulations. Access was ultimately denied in the Midtec case based on the absence of evidence that the carrier acted in an anticompetitive manner. Moreover, the shipper involved enjoyed service from another competing transportation mode, as well as from the rail carrier which was seeking increased access. It appears that the objection which formed the basis of the proceeding was not to "monopolistic practices" harming a "captive" shipper, but rather was simply a desire by the shipper for another direct rail competitor in the market, as part of an effort to lower its rates. A brief review of the Midtec case follows.

Midtec, a paper shipper served by the Chicago and North Western Transportation Company (CNW), sought to have the Soo Line Railroad Company (Soo) serve its mill through the imposition of a reciprocal switching agreement under 49 U.S.C. § 11103(c) and use of the CNW's terminal facilities under § 11103(a). In Midtec I, the Commission denied

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60. Ex Parte No. 445 (Sub-No. 1), supra note 38, at 8.
61. 49 C.F.R. § 1144.4(b) (1986).
the requested relief, finding that a grant of terminal access or reciprocal switching did not meet the statutory public interest standard. Specifically, it determined that the request for access was simply a preference for the opportunity to obtain lower rates, as opposed to a showing that service rendered was inadequate and impaired Midtec's ability to compete. The Commission also found that the imposition of a reciprocal switching agreement would not be necessary to provide competitive rail service due to substantial intermodal competition from motor carriers and joint rail-truck movements, as well as geographic competition from other sources of supply. The consideration of intermodal competition by the Commission was a reversal of its prior position, in which it had ignored forms of competition other than that existing between rail carriers.

The Commission's analysis in *Midtec I* had been criticized since its examined, in part, the reasonableness of the rail rates charged by the CNW. Specifically, the Commission stated:

Having failed to show that CNW is market dominant, Midtec has not shown that the pertinent CNW rates are unreasonably high. Thus, it has failed to establish the predicate of its request for relief.\(^{63}\)

Yet, the Commission noted in its decision that *the sole basis for the shipper's allegations* in seeking increased access was the unreasonableness of the rates charged—not that existing service was inadequate or that the rail rates charged were noncompetitive with motor carrier rates. Despite the focus of these allegations, any inference raised by *Midtec I* that a market dominance and rate reasonableness analysis would be used in competitive access proceedings was expressly overruled in the Commission's subsequent decision in *Midtec II*.

Following closely on the heels of the parties' appeal of the *Midtec I* decision to the D.C. Circuit Court of Appeals, the Commission requested remand of *Midtec I* for reconsideration in light of the issuance of its regulations governing Intramodal Rail Competition.\(^{64}\) Although remand was requested and granted, relief was again denied by the Commission after full reexamination. The Commission's analysis in *Midtec II* follows the framework adopted by the regulations, focusing on evidence of anticompetitive conduct or abuse, and considering any evidence of inadequate service or excessive prices as constituting conduct which is inconsistent with the competition policies of 49 U.S.C. § 10101(a).

In conducting its analysis in *Midtec II*, the Commission regarded the "key issue" to be whether CNW had acted in an anticompetitive manner. The inquiry focused on whether CNW had exerted market power to ex-

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\(^{63}\) *Midtec I*, supra note 62, at 364.

\(^{64}\) In a decision dated October 31, 1985, the Commission determined that the *Midtec I* proceeding should be reopened and reconsidered, on the basis that the rulemaking proceeding bore materially on the issues in the *Midtec I* case.
tract unreasonable terms on through movements or whether its monopoly position enabled it to render inadequate service to the shipper.65

However, neither Midtec nor Soo submitted information necessary to examine allegations that CNW had refused to offer Midtec competitive rates and service. The Commission made significant note of the absence of data on costs, revenues, rates, divisions and efficiency of routings, which were necessary to determine whether access had been granted on reasonable terms. This information is specifically referenced in the Commission’s regulations as relevant to the Commission’s determination of whether a failure to grant access is anticompetitive.

On this point, the Commission stated:

As previously noted, our rules emphasize several categories of specific information for evaluating the types [of] allegations made here as they relate to a possible abuse of market power. These categories include the revenues of the involved railroads, the comparative efficiency of routings, the comparative cost/revenue ratios for the carriers, and the rates sought to be charged. Despite the fact that this proceeding was reopened specifically for consideration under the new rules, complainants, on whom the burden of proof rests, have not submitted any of the specific evidence called for. There are no numbers in the record to give substance to complainants’ allegations.66

Rather, the Commission noted evidence submitted by CNW which demonstrated CNW’s willingness to alter routing at the request of Soo, and to develop competitive rates and service, including rate reductions granted Midtec by CNW for woodpulp and paper traffic.67

According to evidence submitted, Midtec, although directly served by only one railroad, uses a combination of rail, motor, water carrier and intermodal service, with CNW participating in slightly over 60% of its traffic.68 In fact, some of these rail movements were through movements—either joint or combination rates—in which Soo participated. This led the Commission to comment:

Complainants have not alleged that CNW has refused to grant access; rather they object to the terms under which it has been or will be granted. Specifically, they allege “a refusal to offer competitively based rates and services.” Thus it is appropriate to focus on the terms under which through service has been offered and the quality of service that CNW has provided. (Footnote

65. See MIDTEC II, supra note 62. The focus of the Commission’s inquiry on reciprocal switching was the same used in examining whether the public interest required the imposition of terminal trackage rights. As noted by the Commission, while the regulations do not cover terminal trackage rights, the underlying public interest test is the same as that governing reciprocal switching and the analysis should be similar. Specifically, the Commission regarded “a focus on anticompetitive conduct (or the imminent threat of it)” to be an appropriate, but not necessarily the exclusive inquiry in terminal trackage rights determinations. Id. at 178.

66. Id. at 182.

67. Id. at 183.

68. See id. at 175-176. See also, Appendix I to MIDTEC II.
In the absence of evidence of anticompetitive behavior, the Commission viewed the proceeding as one in which Midtec simply sought to increase the presence of a second railroad in the market. The Commission found it inappropriate to intervene in a situation in which no competitive failure occurred, commenting:

There is a vast difference between using the Commission’s regulatory power to correct abuses that result from insufficient intramodal competition and using that power to initiate an open-ended restructuring of service to and within terminal areas solely to introduce additional carrier service.70

This analysis is consistent with prior statements of the Commission that in cases in which joint terminal use is sought, some actual necessity or compelling reason for that use must be demonstrated, beyond a mere desire for additional access that would be convenient or desirable.71

Consequently, the record, as characterized by the Commission, showed no abusive or anticompetitive conduct, but rather demonstrated that CNW’s service had been responsive and adequate. The Commission did comment that the “behavior of the respondent railroad is likely to have been affected by the notoriety attending this proceeding” and warned that “[s]hould the conduct of the respondent railroad deteriorate, or should the behavior of any other carrier exhibit anticompetitive abuse or other offense to the standards of the Interstate Commerce Act, we will grant relief.”72

Midtec has appealed the Commission’s decision to the D.C. Circuit Court of Appeals.73

V. THE CURE ATTACK: ACCESS AND USE ON DEMAND

As discussed, the reforms of the Staggers Act have been a resounding success in achieving the desired goals of promoting efficient rail service, reducing unnecessary and stifling regulation, and fostering the financial health of the rail industry. It is evident that the shipping community has also benefited from these reforms, in terms of stability in rates, efficient and reliable service, and flexibility through contracting to fashion terms and conditions of service in accordance with particular needs.

Unfortunately, a group of coal producers and large utilities—the

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69. MIDTEC II, supra note 62, at 177.
70. Id. at 174.
72. MIDTEC II, supra note 62, at 174-175.
CURE group—have proposed legislation to unravel the achievements of deregulation. This group, faced with cheaper foreign sources of coal and the plummeting cost of oil, is seeking to alter the framework of rail rate regulation and competitive access determinations. This effort has one basic goal: to reduce rail rates for coal.

Any mandated reduction in rates for a specific commodity would have a destructive effect on the rail carriers' ability to differentially price. Any such mandated reduction would require rail carriers to increase rates on other traffic. As a result, traffic subject to intermodal competition would shift to other transportation modes where it could move at lower rates, leaving the rail carriers with less market share and decreased sources of revenue to cover their costs. Any contribution made by those shippers to capital and operating costs would be lost, forcing carriers to make up that shortfall through rate increases on the remaining traffic to the extent competitive pressures permit. The ultimate effect would be a loss of the ability to differentially price rail service, resulting in rate increases, lost traffic, decline in revenues, lost jobs, and deterioration in service—the same litany of woes, it should be noted, that characterized the rail industry in the days of significant Government regulation.

A. THE CURE LEGISLATION

Section 9 of the Consumer Rail Equity Act,\(^\text{74}\) would create new standards for prescribing joint rates, use of terminal facilities, and establishment of reciprocal switching agreements.

1. JOINT RATES

Section 9(a) would add a requirement to current law that any rail carrier providing service under a single line or joint line rate on a particular category of traffic between an origin and a destination must, upon the request of another carrier, a shipper, or a receiver, participate in "at least one competitive joint rate" or publish "a competitive proportional rate." A rate is conclusively deemed competitive if the ratio of revenue to variable costs realized is no higher than that realized on the carrier's single line rate or its existing joint rate.

2. TERMINAL FACILITIES

Section 9(b)(1) would require the Commission, upon request of any "interested rail carrier, shipper, receiver or other party directly impacted" to mandate use of terminal facilities by another rail carrier if it is practica-
3. Reciprocal Switching

Section 9(b)(2) would require the Commission, upon petition of any interested rail carrier, shipper, receiver, or other party directly impacted to establish the compensation for reciprocal switching at a level not to exceed the market dominance threshold level (presently a revenue to variable cost percentage of 180%), unless the carrier demonstrates that a higher level is reasonable and necessary. This would replace current law which permits the parties to establish the conditions and compensation of a reciprocal switching agreement, and under which the Commission’s authority to establish such agreements is discretionary in nature.75

Section 9(b)(2) would prohibit a carrier from cancelling a reciprocal switching agreement except on a minimum of 45 days notice, unless a showing could be made that the continuation of reciprocal switching is not practical or is unnecessary to provide alternative competitive rail service. The Commission would be required to suspend the proposed cancellation if it determines that a shipper has or would utilize such reciprocal switching for a significant portion of its current or future transportation needs.

Similarly, the Commission would be directed to require carriers to enter into reciprocal switching agreements, upon petition of any interested rail carrier, shipper, receiver, or any other party directly impacted, if it finds such agreements to be practicable and in the public interest or necessary to provide alternative competitive rail service. The Commission would be required to act on a petition within 180 days of its filing.

Finally, section 9(b)(2) would require the Commission to ignore the revenue adequacy of a carrier and “the alleged existence of competition other than rail competition between the origin and destination of the traffic involved.”

B. CRITIQUE OF THE CURE LEGISLATION: "THE CURE FOR THE HYPOCHONDRIAC"

1. JOINT RATES

Section 9(a) of the CURE bill would mandate that a rail carrier establish on request a joint or proportional rate for any traffic movement at a certain prescribed level. This provision would effectively require carriers to establish rates on any requested route, regardless of its efficiency. Moreover, the rate established must be set at an arbitrary, fixed level, without regard to the demands of the market and costs of service on that route. In effect, this provision undermines the carrier’s ability to set rates competitively in accordance with its costs and the demand for the service. If pricing is artificially set, it would adversely affect a rail carrier’s ability to differentially price its services for its remaining traffic. It will also adversely affect a carrier’s ability to price its competitive traffic at a level conducive to retaining its market share, as compared to that share enjoyed by other transportation modes. If competitive traffic is lost, the remaining shippers suffer not only in terms of rates—as they must shoulder a greater proportion of the fixed costs—but also in terms of the quality of service they will receive.

The thinking embodied in § 9(a) is oblivious to the fact that other forms of competition exist in transportation markets, even if direct rail to rail competition does not. Alternate transportation modes and other sources of supply for commodities do effectively constrain rail carriers’ ability to set rates, yet are not considered for purposes of setting joint rates under this section. Moreover, section 9(a) is unnecessary, given the Commission’s recent issuance of regulations which seek to address the cancellation and prescription of joint rates and through routes. Relief is therefore available to shippers and connecting carriers to prevent, through suspension, and to remedy, through investigation and prescription of rates and routes, anticompetitive behavior by rail carriers.

Perhaps the most alarming fact about section 9(a) is the apparent intent to return to the system of rate equalization and open routing that existed prior to the enactment of the Staggers Act. As discussed, this system promoted inefficient routing of traffic and uneconomic rates, and provided artificial support for costly, noncompetitive routes and unjustified cross-subsidization of traffic. To return to a system that was character-

76. As explained in the AAR’s Compendium Summarizing and Analyzing the Proposed CURE Bill, A Critique of the Proposed C.U.R.E. Bill, Attachment at 5, if a shipper attacks price levels through the competitive access provisions of the Interstate Commerce Act, where there is no showing of anticompetitive conduct, it is evidence of an effort on the part of a shipper to destroy differential pricing by attempting to drive down rail rates through forced direct rail to rail competition.
ized by heavy Government interference and uniform pricing for rail services—a system that nearly crippled the rail industry and harmed railroads, shippers, and the consuming public—is short sighted and ill conceived public policy.

2. **Terminal Facilities**

Section 9(b)(1) of the CURE bill would require the Commission to mandate the use of terminal facilities on request and would alter the standard used to determine the circumstances under which use should be required. Every facility could be subject to the requirements of this section, once it is found that use of the facility is "necessary for the provision of alternative competitive rail service." Once again, the presence of other competitive forces is ignored. The effective constraint presented by intermodal competition on the pricing of rail services is specifically eliminated as a consideration in determining whether such use should be granted.

Required use on demand by any "party directly impacted" under this provision undermines the carrier's ability to earn an adequate return on its investment and to stimulate further capital investment in facilities. As articulated by one commentator:

> Unless the owning railroad is fully compensated, competitive access will simply be an euphemism for the uneconomic subsidization of the entrant by the owning carrier, ultimately resulting in the owner becoming unable to maintain the facility which is the subject of the access.77

This is particularly troublesome, since section 9(b)(1) also alters the standard for fixing compensation to be paid to the owning carrier. This section moves away from the current standard—that controlling compensation in condemnation proceedings—to one which would simply compensate the owning carrier for costs incurred by the use.78

The competitive access provisions of the CURE bill are designed to increase the number of competitors in a given market as part of an overall effort to reduce rates. This presents two major concerns. First, a deliberate effort to promote the entry of individual competitors, as opposed to generally enhancing competition, is directly contrary to the objectives of the antitrust laws and traditional interpretation by the courts and the De-

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78. The Association of American Railroads argues that this standard may constitute a taking without just compensation in that it would not take into account the full terminal costs incurred by the owning carriers, nor would it include revenues lost by the owning carrier due to the loss of market share to the carrier entering the market. *Hearings on the Rail Industry and the Staggers Act Before the Subcomm. on Surface Transp. of the Senate Comm. on Commerce, Science and Transp., 100th Cong., 1st Sess. (1987)*, statement by William H. Dempsey, President, Association of American Railroads at 34.
partment of Justice. Secondly, a competitor should not be given access on demand simply in order to secure lower rates in instances in which the rate charged is not determined to be unreasonably high. A carrier which enters a market relying on the use of another’s track and facilities will have lower costs, and thus will be able to charge a lower rate. This unfairly undercuts the owning carrier, reducing its traffic base and its revenues and contribution toward investment, and unfairly subsidizes the new entrant.

3. **Reciprocal Switching**

Section 9(b)(2) requires the Commission to establish reciprocal switching agreements and to fix the level of compensation at the threshold used by the Commission for jurisdictional purposes in rate proceedings. The burden would be on a carrier to establish that a higher level of compensation would be both reasonable and necessary. The regulatory intrusion of the Commission where there is no evidence of anticompetitive behavior coupled with an arbitrary setting of terms and conditions for switching would adversely affect the pricing of services and would, as discussed above, lead to a loss of revenues and market share.

The language of section 9(b)(2) would require the Commission to suspend the cancellation of a reciprocal switching agreement, if a shipper would use the switching for a significant portion of its transportation needs. This standard for suspension borrows from the Commission’s regulations on suspension standards for cancellation of joint rates and through routes, but in so doing only adopts half of the standard. Specifically, it eliminates from consideration whether the cancellation would eliminate effective rail competition for the affected traffic.

Under section 9(b)(2), cancellations would be prohibited and reciprocal switching agreements must be established by the Commission in instances where switching is necessary to provide "alternative" competitive rail service. Accordingly, section 9(b)(2) amends the current discretionary standard to one which requires the Commission to provide...

79. See Brown Shoe Co., Inc. v. United States, 370 U.S. 294 (1962), which found Congressional intent inherent in antitrust policy to be the protection of competition, not competitors. As noted by Marshall and Cook in *Issues of Cost Recovery in the Debate over Competitive Access*, 15 Transp. L.J. 9, at 13, the Commission’s Intramodal Rail Competition regulation focused on "preservation or enhancement of efficiency and competition, not the preservation or enhancement of particular competitors."

80. See Marshall and Cook, supra note 32, at 13, n.20. "The issue raised by . . . requests for access intended to defeat lawful rates is whether, and if so, when, a rate that meets the maximum rate reasonable criteria can nonetheless be anticompetitive. If this issue is resolved in the affirmative, it must be determined whether relief should come in the form of a lower rate or a grant of access."

81. See 49 C.F.R. § 1144.3(c) (1986).
for switching and turns on the promotion of "alternative" rail service. This standard appears to require the introduction of another direct rail competitor, regardless of the existing level of competition present in the market.82

Finally, section 9(b)(2) directs the Commission, in making its reciprocal switching and terminal facilities determinations, to disregard the revenue adequacy of carriers and any competition other than direct rail competition that may exist for the movement of the traffic at issue. Such an inquiry is akin to conducting the proceeding with blinders on—it ignores the true nature of the competitive market and unfairly hampers the carriers' ability to compete for transportation services by pricing in a manner that will attract and retain traffic. This constitutes nothing more than an attempt by the CURE coalition to manipulate and artificially construct an analysis which will with certainty render a result in its favor.

C. STATUS OF REREGRULATORY EFFORTS

In the current Congress, several hearings have been held in both the Senate83 and the House of Representatives84 on the CURE legislation and the financial health of the rail industry. While formal consideration in the Senate Committee on Commerce, Science and Transportation did not occur in the first session of the 100th Congress, markup did occur in the House Subcommittee with jurisdiction over rail legislation. On November 5, 1987, the House Subcommittee on Transportation, Tourism and Hazardous Materials, approved for consideration by the full Committee on Energy and Commerce, legislation modeled after the CURE bill.85

Section 9 of the legislation addresses the competitive access issue. Section 9(a) adopts essentially the same language as the CURE bill on joint rates, requiring a railroad to participate in an alternative joint rate with a connecting carrier on request of a shipper, receiver, or carrier for the movement of any traffic. The joint rate so established would be effectively capped at the existing single line rate. No showing of inadequate

82. In noting that this provision would ignore the presence of even direct transportation competition in the market, the AAR in their testimony, supra note 78, at 36, comments that the Commission's concern in competitive access determination should more properly be the prevention of anticompetitive conduct and the assurance of competition in instances where it is required by the public interest.


85. The Subcommittee vote was 9 (aye) to 6 (no).
service, excessive pricing or anticompetitive behavior need be made to support the request for the joint rate.

Section 9(b)(1), relating to terminal facilities, sets two standards similar to those included in the CURE legislation under which access to terminal facilities could be granted. The first requires the Commission to find that the use is practicable and that there is "no alternative competitive transportation service available". Under the second standard, the Commission could require use on finding that the use is otherwise in the public interest but would not substantially impair the rail carrier's ability to handle its own business.

Under the first standard, the Commission would not be required to consider whether the use was necessary to provide alternative competitive rail service by the entering carrier, as specified in the CURE bill. Rather, the Commission would be required to find that no alternative competitive transportation service was available. Although this language appears to require consideration of existing transportation competition, additional language in section 9(b) provides that the fact that a shipper has used or is using alternative transportation service does not, by itself, demonstrate that the alternative transportation is economically feasible. Although unclear, it appears that this provision requires the Commission to determine if existing transportation competition is competitive on an economic basis, in effect requiring that alternative transportation to be at the same or a lower cost in order to be considered "competitive." In conducting its competitive analysis, the Commission is prohibited from considering the existence of product and geographic competition, and is also precluded from examining whether the rail carrier involved is revenue adequate, as in the CURE bill. Still missing from the Commission's inquiry under this language would be any consideration of whether the railroad presently providing service acted in an anticompetitive manner or provided inadequate service to the shipper. Thus, this provision in effect provides a "remedy" without necessitating that a showing be made that harm occurred, and also suffers from the same criticism applicable to the CURE bill that it facilitates relatively free access in order to put a downward pressure on rates, and will result in diminishing the railroads' return on investment.

Section 9(b)(2), relating to reciprocal switching, is likewise very similar to the CURE bill, requiring the Commission to establish reciprocal switching agreements if it is practicable and in the public interest or is

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86. Section 9(a) of the Subcommittee bill defines the term "terminal" to include without limitation any rail facilities used, or which could practically be used, for the interchange of cars between rail carriers at the time the request for access is made. The term "terminal facilities" is defined to include without limitation all tracks and other rail facilities needed to serve points within twelve miles of any terminal.
necessary to provide alternative competitive transportation service.\textsuperscript{87} If the Commission is requested to prescribe the compensation for reciprocal switching, section 9(b)(2) caps the compensation at the then current jurisdictional threshold,\textsuperscript{88} unless the carrier can demonstrate that a higher level of compensation is reasonable and necessary. Cancellation of reciprocal switching agreements must be preceded by 45 days notice, unless the carrier can show that the continuation of reciprocal switching is not practicable or its unnecessary to provide alternative competitive transportation service. A cancellation would be suspended if the shipper involved had utilized or would utilize the service for a significant portion of its transportation needs.

While the legislation appears to adopt some aspects of the Commission's regulations, it does so only in part. The suspension standard is similar to a portion of that adopted by the Commission, leaving out a requirement that a showing be made that the proposed cancellation would eliminate effective railroad competition for the affected traffic.\textsuperscript{89} Further, all that need be shown to require the Commission to prescribe a reciprocal switching agreement is that it is necessary to facilitate "alternative" competitive transportation service. Any new entrant into a market by its mere presence necessarily provides "alternative" service. Again, no anticompetitive conduct need be shown for a switching agreement to be prescribed, in effect granting access on the mere desire of a shipper or carrier.

Finally, by effectively capping the compensation for reciprocal switching at the jurisdictional threshold, the Commission would be not only setting rail pricing but would be doing so in a manner that is arbitrary and unresponsive to market demands. The burden would be placed on the carrier to justify a higher amount, requiring with certainty a regulatory proceeding and Commission determination on the matter. This is "reregulation" in its truest form.

Section 9(b)(3) of the Subcommittee bill prohibits the Commission from considering the revenue inadequacy of a rail carrier and the existence of either product or geographic competition in assessing whether the use of terminal facilities or reciprocal switching should be provided or maintained. Although this language would seemingly permit the Commission to examine the existence of intermodal competition in the market, it

\textsuperscript{87} Section 9(b) of the CURE bill requires the Commission to establish reciprocal switching agreements if it is practicable and in the public interest or is necessary to provide alternative competitive rail service, which in effect excludes the consideration of intermodal competition.

\textsuperscript{88} The jurisdictional threshold is used for purposes of determining whether the Commission has jurisdiction over a rate charged by a carrier claimed to be unreasonable. See 49 U.S.C. § 10709(d)(2) (1982).

\textsuperscript{89} See 49 C.F.R. § 1144.3 (1986).
would direct the Commission to conduct a competitive analysis which ignores the financial strength of a carrier to compete for market share and to withstand the loss of traffic to a new entrant. In addition, it ignores any competition posed by alternate sources of supply and substitute products for the commodity being shipped, even if those competitive alternatives are an effective constraint on rail rates.

Finally, section 9(b)(3) of the Subcommittee bill exempts Class II and Class III railroads from the requirements of the reciprocal switching and terminal facilities provision. This provision was probably designed to mitigate the concerns of smaller rail carriers which were concerned about loss of traffic, revenues, and market share to competing carriers resulting from the grant of access. It appears that the Subcommittee has been responsive to those concerns, but ignored or simply dismissed similar concerns of the larger railroads.

VI. CONCLUSION

In evaluating the public policy merits of the CURE legislation, consideration should be given to George Santayana’s admonition that those who do not understand history are doomed to repeat it. In the pre-Staggers era, two of the critical factors that emerged as contributing to the financial crises in the rail industry were the proliferation of uneconomic rates and routes, imposed or kept in place by Government regulation, and the carriers’ extremely low rate of return and inability to attract capital to make needed investments. There should be no mistake that the system of re-regulation reflected in the CURE legislation, with its emphasis on the prescription of joint rates and the nearly unfettered use of other carriers’ tracks and facilities, poses an enormous risk of returning to a regulatory system that embodies many of the same flawed public policies which the Staggers Act sought to overturn.
Railroads and the Marketplace

Frank N. Wilner*

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I. INTRODUCTION**

Railroads have been regulated longer than most Americans have been alive. Grover Cleveland was serving his first term as president when the Interstate Commerce Commission (ICC) was created in 1887\(^1\) to regulate rail rates and services—making railroads the first American industry to be brought under federal price controls. At the time, almost all domestic passenger and freight travel was by rail. Alternative transport was limited to horse and wagon over deeply rutted and often muddy roads, by steamboat on crudely improved rivers and canals, or by ocean packets under sail. Orville Wright was still a teenager.

Seventeen different presidents have occupied the White House since the passage of the original Interstate Commerce Act. The Panama Canal was constructed, permitting ocean liners rapid intercoastal transit. More than two million miles of roadway have been paved at taxpayer expense, including some 41,000 miles of high-speed interstate highway. Some 20,000 miles of inland waterways have been improved with public funds to facilitate commercial barge transport. Since World War II, pipelines have been utilized to transport most petroleum products. Jumbo cargo jets can fly coast-to-coast in five hours.

For decades, freight transportation in the U.S. has been competitive. But arcane, antiquated and rigid economic regulation prevented the railroads from competing—competing with each other and with trucks and barges.

Railroads were, until 1980, regulated as if they still held the vast market power that they did a century earlier. In 1957, Business Week magazine, "railroads have not had a practical monopoly of the transportation business for over thirty years."\(^2\)

Nonetheless, federal and state regulations required railroads to petition for permission to raise or lower rates or adjust levels of service in response to changing economic conditions. Many rail-competitive truck and barge operators faced no such requirements, permitting them to react rapidly to changing markets and to ravage rail business with impunity. Rail pricing officers were, in the words of former Federal Railroad Administrator Robert W. Blanchette, "in the in-box of bureaucrats."

Railroads were also used as instruments of social policy. Railroads

** The Transportation Law Journal is not responsible for the accuracy of statistical data contained in this article.
were required to make distant producers more competitive with local producers in a given market; to give preference to certain ports or regions of the nation; to help protect farm income; to help prevent unemployment; and to provide money-losing freight and passenger transportation as if railroads were philanthropic agencies.

By the mid-1970s, the rail industry was plagued by bankruptcies. The threat of nationalization hung over many railroads like the sword of Damocles. An estimated cost to taxpayers of nationalizing the freight railroads was $100 billion\(^3\) and that would have been just the beginning. Economic efficiency always takes a back seat to political expediency.

Shippers and railroads alike rejected the nationalization alternative. Congress was equally chary—it knew that the pockets of the public treasury were not sufficiently deep. Indeed, the combined operating deficits of the nationalized rail systems in France, West Germany, Great Britain, Japan and Italy—systems whose combined route mileage is less than forty percent of U.S. railroads—exceeded the equivalent of $2.6 billion annually in 1971.\(^4\)

Having tried strict economic regulation—and seeing it fail—and having rejected complete nationalization—because of excessive cost and resulting ineffectiveness—policy makers were left with two options. The first was nationalization of only bankrupt and financially weak roads. But, observed the U.S. Department of Transportation (DOT), "it is difficult for the federal government to become a limited partner . . . such piecemeal nationalization would weaken—and perhaps eventually destroy—the vigor of the private enterprise companies that would be forced to compete with the federally backed operation."\(^5\)

A more efficient solution—a healthy dose of the free market—was chosen. "Reasonable rates," said Congress, should be set by "competition and the demand for services . . . to the maximum extent possible."\(^6\) Congress sought to loosen the reins of existing economic regulation, to give railroads an opportunity to earn adequate revenues—revenues that would attract the necessary new investments to renew facilities and prevent railroads from becoming wards of the public treasury.

To accomplish this, Congress in October 1980 passed the Staggers Rail Act\(^7\)—named in honor of retiring Congressman Harley O. Staggers,

\(^3\) Ry. Age, Apr. 24, 1972.
\(^5\) Id. at 3.
chairman of the House Committee on Interstate and Foreign Commerce, where the legislation originated.

The Staggers Act did not completely deregulate the railroad industry. The measure limited the ratemaking jurisdiction of the ICC to instances where rail carriers are shown to have "market dominance" (the absence of effective competition) and where the rates at issue exceed variable costs\(^8\) by a prescribed percentage.

Evidence reveals the Staggers Act to be the most successful piece of transportation legislation ever passed by Congress. Despite a long and deep recession shortly after the Act was passed, and the on-set of a period of no-growth for freight traffic, no new rail bankruptcies occurred. Existing bankruptcies were restructured successfully within the private sector.

The railroads have been able to survive in this difficult business environment because operating costs have decreased sharply, extraordinary cash-flow benefits have stemmed due to 1981 tax-law changes and purchases of equipment have declined.

Since Staggers was enacted, productivity and the quality of rail freight service have improved dramatically. Many rail rates have fallen, while rate increases are more moderate than before Staggers. Competition among railroads has increased, and the railroad industry is competing more successfully with trucking and shipping.

"A leaner industry haws become more competitive under deregulation," said Nation's Business magazine.\(^9\) Observed Fortune magazine: \(^10\)

"The Staggers Act did not leave shippers totally at the rails' mercy." U.S. News and World Report commented: \(^11\) "In the world's largest free-market economy, entire industries are becoming accustomed to something they had long lived without: competition."

In a Cato Institute policy analysis, Kansas State University Professor Michael W. Babcock stated: \(^12\)

[the Staggers Act] is a significant step toward economic efficiency in the rail

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8. Variable costs are those that fluctuate directly with the rate of output—train labor, fuel, depreciation due to wear and tear of operations, most maintenance and repair. But to remain in business, railroads also must earn sufficient revenues to cover their fixed costs.

Fixed costs are those unaffected by the rate of output—track grading, ties, ballast, signals, buildings, minimum maintenance, management, interest on debt, property taxes, and depreciation related to obsolescence and weather. The additive of variable and fixed costs produces total costs.


industry. Railroads are now able to adjust their rates and service to changing market conditions and are no longer required to provide money-losing service. With a policy based on free-market principles, railroads will continue to play a major role in the U.S. economy.

II. A NATIONAL PROBLEM

The bankruptcy of the Penn Central Railroad in 1970—following decades of industry decline—seemingly set off a chain reaction, which, by 1975, saw virtually every railroad in the Northeast filing for protection from its creditors.

With the bankruptcies of the Chicago, Rock Island and Pacific Railroad (Rock Island) and Chicago, Milwaukee, St. Paul and Pacific Railroad (Milwaukee Road) in the mid-1970s, no section of the nation seemed immune from railroad failure.

By the Late-1970s, more than 21 percent of the nation’s rail route mileage was being operated under the gavel of bankruptcy courts—approaching the 33 percent of the mileage in receivership at the height of the Great Depression.

“The railroad industry problem . . . is a nationwide transportation problem,” Transportation Secretary Brock Adams told a U.S. Senate Committee in 1979. This is because more than half of all rail freight travels over two or more railroads, making the Nation’s rail system only as strong as its weakest links.

The fact that some railroads were financially sound during the 1970s was of minor consequence to a shipper on such lines whose freight was designed to a region served by a bankrupt or deteriorating carrier. That an originating railroad might move freight efficiently mattered little if the destination carrier’s track limited train speeds to ten miles per hour and its decaying terminals promise further delays.

A 1975 DOT study said that less than two-thirds of rail shippers found rail equipment availability and rail service to be adequate. The same study reported that almost 97 percent of truck shippers found motor-carrier equipment availability and service to be adequate.

The rail industry in 1976 faced a ten-year capital shortfall of as much

15. Internal Analysis of Operations and Maintenance Department, AAR. [Hereinafter cited as O&M].
as $16.2 billion—excluding Conrail. This was despite the fact that the ICC had permitted railroads to raise freight rates by thirty-two percent from 1967 through 1971—or more than ten percentage points greater than the 21.3 percent rate of consumer inflation.

Railroads did not have the capital to properly maintain their track. The number of train accidents caused by track defects nearly quadrupled between 1966 and 1976. By 1976, 47,203 miles of track—25 percent of rail route miles—were restricted as to speed because of dangerous conditions. Plagued by substandard profits—or no profits at all—many railroads deferred maintenance and delayed capital improvements in anticipation of better days that never arrived. By June 30, 1976, the value of accumulated deferred maintenance and delayed capital improvements exceeded $2.8 billion for track, yards and terminals, and another $1.3 billion for equipment—and this did not include Conrail.

Though the ICC had permitted some 68,000 miles of rail line to be abandoned between 1920 and 1975 (about 0.4 percent of total rail mileage annually), the rate of abandonment was not sufficient—in the face of more rapidly eroding business and changing transportation patterns—to prevent massive and costly excess rail capacity.

The excess capacity problem became so pervasive that in 1975, 33 percent of the nation’s rail route miles carried only one percent of the freight; 66 percent of all rail freight was carried over just 20 percent of the route miles. Between Chicago and Kansas City there remained eight mainline routes; five between Dallas-Ft. Worth and Houston; and five between Chicago and Minneapolis. Chicago continued to be served by 22 railroads operating 105 separate terminal yards.

III. CAUSES OF RAILROAD DECLINE

The development of railroads in the United States during the 19th Century was in response to a demand for adequate and dependable overland transportation. Early government promotion of railroads permit-
ted various national objectives to be fulfilled.\textsuperscript{26} It also resulted in over-
building, concentration of market power and a number of commercial
abuses—common in other early American industries as well—that would
not be tolerated today.

Passage of the Interstate Commerce Act and creation of the ICC in
1887 was in response to a fundamental change in public attitude toward
railroads. The institution of maximum rate regulation alongside require-
ments that railroads fulfill politically defined social goals was tempered by
the institution of rate floors. In theory, emerging regions, infant industries
and selected shippers could be nourished through preferential rates and
services while, at the same time, railroad revenue adequacy could be
assured.

By the time the U.S. railway network reached its peak of 254,000
route miles in 1916,\textsuperscript{27} the economic environment that spawned the Inter-
state Commerce Act had changed dramatically. Events were to carry the
nation's oldest, largest and most successful industry to the brink of
nationalization.

Beginning with the Transportation Act of 1920,\textsuperscript{28} government at-
ttempted (and failed) to preserve a healthy national rail system while pro-
moting the development of alternative domestic modes of transportation.
In 1925, Congress passed the Hoch-Smith resolution\textsuperscript{29} that directed the
ICC, in regulating freight rates, to give preferential treatment to agricultural
interests.

Tax dollars were used to build and maintain rights-of-way for rail
competitors. Between 1946 and 1975 alone, federal spending on high-
ways exceeded $81 billion; on airports and airway supervision, $24 bil-
lion; on inland waterways, $10 billion; and on railroads, $1.3 billion.\textsuperscript{30}

The Motor Carrier Act of 1935\textsuperscript{31} exempted from economic regulation
most agricultural products moving by truck, and also exempted manufac-
turers and distributors who transported their own goods (private car-
rriage). The Transportation Act of 1940,\textsuperscript{32} while extending economic
regulation to barge lines, exempted their movement of bulk commodities
such as coal, ore, grain and chemicals, which represented the vast por-
tion of their business. Yet, strict economic regulation of rail operations
continued—as if railroads remained a transportation monopoly. But rail
markets were not protected—and certainly they were not secure. Secre-

\textsuperscript{26} Internal Memorandum, E&F, AAR, supra note 13.
\textsuperscript{27} F. Wilner, Railroad Land Grants: Paid for in Full (Washington, D.C., AAR, 1984).
\textsuperscript{28} Transportation Act of 1920, Ch. 91, 41 Stat. 456.
\textsuperscript{29} Pub. Res. No. 46, Ch. 120, 43 Stat. 801 (1925).
\textsuperscript{30} Study of Federal Aid, supra, note 22, at 10.
tary of Transportation William T. Coleman, Jr. explained in 1975 that:33

Only the railroads (with the exception of the pipeline companies) own their
own rights-of-way and have to carry the fixed charges of ownership (including
property taxes) and maintenance of this extensive plant.

In a misguided attempt to protect alternative forms of transportation,
 rates on much of the rails' competitive business were held by regulators
to levels above those charged by barge and truck lines. A steady erosion
of rail traffic and rail revenues ensued. Still, railroads were not relieved of
their social-service obligations—such as uneconomic branch-line oper-
ations, and preferential treatment of certain regions, ports and shippers.

Declared Pennsylvania Railroad President James Symes in 1957,34
"If railroads have to live for the next 10 years under the same conditions
they have for the past 10, they will be in the hands of the government."35

Stated the U.S. Department of Transportation in 1973,36 "Regulatory
practices have produced a rigid pricing structure which, for rails in partic-
ular, has prevented them from responding to the needs of a changing
market."

Through much of the post World War II era, many railroads con-
sumed themselves. The large scale of rail plant and the existence of
long-lived assets masked the financial plight of many railroads until large
segments of the industry collapsed beginning in the 1970s.

Not since the 1950s has railroad return on net investment equaled
the industry's cost of capital; and in every year between 1963 and 1980,
railroad capital expenditures exceeded retained earnings.37 To operate
oversized systems returning inadequate profits, railroads took on more
and more debt. In the 1970s, interest rates on borrowed money rocketed
to double-digits. Between 1970 and 1979, the rail industry's return on net
investment never exceeded three percent—and dropped as low as 1.2
percent in 1975.38 By then, Penn Central was losing $2 million each
day.39 Billions of dollars in federal loans and loan guarantees to Penn
Central's federally created successor, Conrail—as well as other finan-
cially strapped railroads—failed to address the fundamental national rail-
road problem of excessive economic regulation and bloated plant.

Poor earnings, poorer prospects, high-debt ratios and the reality of

33. Crisis of the Nation's Railroads, Report Prepared for President Gerald R. Ford, (Apr. 11,
35. Mr. Symes, whose Pennsylvania Railroad was part of the 1970 Penn Central bank-
ruptcy, missed the mark for his railroad by three years. As mentioned earlier, many railroads
remained relatively healthy during the 1960s and 1970s.
36. Northeastern Railroad Problem, supra, note 4 at 11.
37. Internal Memorandum, E&F, AAR, supra note 13.
38. Id. at 11.
bankruptcies virtually squeezed nearly every railroad out of the equity markets. The effects were revealed in deferred maintenance, derailments, train accidents, increasing cargo damage payouts, equipment shortages and spotty service. This, in turn, forced even more shippers—and sorely needed revenues—from the rails.

In 1925, railroads hauled some 80 percent of intercity freight.\(^{40}\) By 1975, the rail share of intercity freight had fallen to under 37 percent.\(^{41}\) In terms of intercity freight revenues, the railroads' share had fallen from 72 percent in 1929 to below 18 percent by the mid-1970s.\(^{42}\)

Viewed from another perspective, between 1947 and 1977, truck tonnage increased by 300 percent and barge tonnage increased by 250 percent—while rail tonnage dropped by 9 percent.\(^{43}\)

In the late 1960s, economist Merton J. Peck, a former member of the President's Council of Economic Advisers, characterized railroad regulation as a wasteful "misallocation of transportation resources." He wrote:

[ICC rate policy has] denied the shipper the advantages of the lower cost transportation by rail, diverted resources toward the high-cost carrier, [and] added capacity to the non-railroad sectors of transportation at a time when the railroads had substantial excess capacity . . .\(^{44}\)

IV. BAND-AIDS ARE APPLIED

Throughout the 1950s and 1960s, the notion of a U.S. president visiting the Peoples Republic of China was unthinkable. The government that ruled mainland China did not exist as far as official Washington was concerned. Until the mid-1970s, a similar barrier existed with the notion of transportation deregulation. Among shippers, politicians and even railroads, deregulation was not a viable option.

Stated President Cleveland after passage of the Interstate Commerce Act in 1887: "... there appears no question that the policy thus entered upon has a permanent place in our legislation."\(^{45}\)

But, Congress noted in 1939: . . .

When the original act to regulate commerce was passed . . . railroads had a monopoly on transportation. In later years, competing forms of transportation have developed with such rapidity that no one now urges that there is any such monopoly . . . other forms of transportation are developed at public


\(^{41}\) Id. at 12.

\(^{42}\) Id.

\(^{43}\) Id.


\(^{45}\) A Compilation of the Messages and Papers of the Presidents, 1789-1897, (1898) (Available at U.S. Government Printing Office).
expense and without supervisory regulation.\textsuperscript{46}

Nevertheless, in passing the Transportation Act of 1940, which expanded motor-carrier regulatory exemptions and provided the bulk-commodity exemption to barge operators, there was no serious consideration of reducing the railroads’ regulatory burden. Declared Congress: “... It may be safely said that neither the strictly regulated railroads nor the motor-carrier operators favor the elimination of all regulation.”\textsuperscript{47}

High-valued merchandise traffic continued to shift from rail to truck, and savvy barge operators learned to win bulk commodities from railroads. Only the extraordinary transportation demands of World War II kept railroads reasonably solvent. Beginning in 1946, however, there began an unceasing financial erosion of the nation’s railroads, leading to the demise of the Penn Central in 1970.

Rigidity born of excessive and inefficient economic regulation hindered the introduction of new services and prevented railroads from competing effectively for a share of the changing transportation marketplace. The railroad industry found itself unable to generate sufficient earnings to make needed improvements in track, roadbed and other facilities. Because of substandard earnings, funds from outside sources increasingly became unavailable.

The Transportation Act of 1958\textsuperscript{48} authorized the Interstate Commerce Commission to “guarantee” $500 million in loans to railroads for capital expenditures and maintenance. In its 1963 annual report, the ICC stated that without such loan guarantees—which expired in 1963—a number of eastern roads would not have survived.\textsuperscript{49}

Even with the failure of Penn Central, Congress continued to avoid the problem of too much regulation—choosing instead to treat the symptoms. A series of “Band-Aid” approaches, designed to stem the deadly hemorrhaging of cash, were instituted.

The Rail Passenger Service Act of 1970\textsuperscript{50} relieved the nation’s railroads from operating money-losing intercity passenger trains by creating the National Railroad Passenger Corporation (Amtrak).\textsuperscript{51} Passenger operations had cost the nation’s privately owned railroads some $1 billion for the four-year period from 1967 through 1970.\textsuperscript{52}

\textsuperscript{46} S. Rep. No. 433, 76 Cong., 1st Sess. 3 (1939).
\textsuperscript{47} Id. at 13.
\textsuperscript{50} The Transportation Act of 1958, supra note 48, at 14.
\textsuperscript{51} The Denver and Rio Grande Western (D&RGW) the Rock Island and the Southern Railway chose not to transfer their passenger divisions to Amtrak when it began operation on May 1, 1971. The Rock Island later was liquidated, while both the D&RGW and Southern subsequently transferred their passenger operations to Amtrak.
\textsuperscript{52} Internal Memorandum, E&F, AAR, supra note 13.
The Emergency Rail Services Act of 1970\textsuperscript{53} authorized federal loan guarantees not to exceed $200 million for bankrupt railroads without sufficient cash to continue "essential" operations.

The Regional Rail Reorganization (3-R) Act of 1973\textsuperscript{54} set the stage for the creation of Conrail from the ashes of six bankrupt Northeast carriers\textsuperscript{55} and authorized $1 billion in federal loan guarantees for their future operation. Additionally, the 3-R Act authorized $558.5 million in direct grants, including $180 million to permit public authorities to purchase Conrail lines slated for abandonment; $250 million to provide mandated lifetime salary protection for displaced rail employees;\textsuperscript{56} $85 million to provide operating subsidies for the bankrupts until they could be reorganized into a single system; and $43.5 million to fund the U.S. Railway Association, which would act as Conrail's planning and financing agency. Also, the ICC was authorized to expedite line-abandonment applications of bankrupt carriers joining Conrail.

"A fast run toward total nationalization of America's railroads,"\textsuperscript{57} observed syndicated newspaper columnist James J. Kilpatrick of these so-called Band-Aid remedies. "Congress seems intent on sending the whole system of capitalism careening to the fate of 'Old 97',"\textsuperscript{58} wrote Railway Age magazine editor Luther S. Miller.\textsuperscript{59}

Crisis legislation directed at immediate needs was not working. The financial problems of the railroads remained. Indeed, they began spreading from the Northeast westward. The Milwaukee Road and Rock Island were nearing bankruptcy and the rail industry's rate of return on net investment—1.2 percent for 1975—was well below the return available on a federally insured passbook savings account. Clearly, the pockets of the general treasury were not sufficiently deep to help rebuild the privately owned railroads' track and equipment and maintain it; and private capital was not forthcoming because of substandard earnings—or, more likely,

\begin{itemize}
  \item \textsuperscript{55} The six bankrupt railroads merged into Conrail were Central of New Jersey, Erie Lackawanna, Lehigh and Hudson, Lehigh Valley, Penn Central and Reading. Bankrupt Boston and Maine Corporation chose to remain independent and subsequently was merged into Guilford Transportation Industries. The Ann Arbor Railroad subsequently was merged into Conrail. Conrail began operations April 1, 1976.
  \item \textsuperscript{56} The Northeast Rail Services Act of 1981 (Public Law 97-35; 95 Stat. 643) repealed lifetime employee protection and placed a $20,000 limit on individual benefits.
  \item \textsuperscript{57} Miller, The Northeast Bill: Foxy Panacea; or What, Fy Age 5, (January 14, 1974).
  \item \textsuperscript{58} A "fast" mail and express operated by the Southern Railway between Washington and Atlanta, that left the tracks at 90 miles per hour on Sept. 24, 1903 on a curve outside Danville, Virginia. Old 97 became the subject of a still-popular folk song.
  \item \textsuperscript{59} Id. at 15.
  \item \textsuperscript{60} Internal Memorandum, E&F, AAR, supra note 13.
\end{itemize}
no earnings at all. Total or piecemeal nationalization was not a workable public-policy option.

As early as 1954, Secretary of Commerce Sinclair Weeks headed a Cabinet Committee on Transportation Policy and Organization that recommended transportation deregulation to President Eisenhower.

On April 5, 1962 (the 75th anniversary of the ICC), in a special message to Congress on transportation, President Kennedy declared:61

The management of the various modes of transportation is subject to excessive, cumbersome, and time-consuming regulatory supervision that shackles and distorts managerial initiative.

Common carriers should be aided in their endeavors to maintain their status by being given relief from the burdens of regulation that handicap them against unregulated competitors . . . The role of public policy should be to provide a consistent and comprehensive framework of equal competitive opportunity. It means greater reliance on the forces of competition and less reliance on the restraints of regulation.

President Johnson, Nixon and Ford also recommended major changes in regulatory practices that would place more reliance upon competition and less upon regulation. It was not until the administration of President Carter, however, that Congress began to think the unthinkable—deregulation.

V. THE RAILROAD REVITALIZATION AND REFORM ACT

The Railroad Revitalization and Regulatory Reform (4-R) Act of 197662 offered the first dose of deregulation since the railroads had come under price controls eighty-nine years earlier. The intent of the 4-R Act was two-pronged: To infuse much needed capital into the rail industry; and to provide railroads greater ratemaking, abandonment and merger freedom so that they could regain their financial independence.

In terms of capital infusion, the 4-R Act authorized 2.1 billion in loans to Conrail; $1.6 billion in loans and loan guarantees to other financially weak railroads for plant and equipment purchases, and mainline track rehabilitation; and 360 million in branch-line subsidies.

The Interstate Commerce Commission was given authority to eliminate rate regulation over types of traffic where its deemed such regulation served "little or no useful public purpose." Rates that were equal to or exceeded variable cost were not to be held up in order to protect other carriers. No rate was to be found too high unless the ICC first found the rail carrier "market dominant" (to be explained shortly). For two years,
railroads were to be given freedom to raise or lower specific rates by as much as 7 percent.

For the first time in the history of rail regulation, the Commission was to develop rate-reasonableness standards that took into consideration the revenue needs of railroads; and to make an annual determination of the rate of return required on net investment for the rail industry to attract and retain private capital.

In the case of mergers, the ICC was to reach a decision within thirty-one months. As for abandonments, time limits for Commission action were set and shipper financial contributions (through purchase or subsidy) were encouraged. The 4-R Act also prohibited discriminatory state and local tax treatment of railroad property.

The 4-R Act's intentions were good—at least the Act addressed the problem and not its symptoms. But it was a halfway measure, and its execution was severely flawed. Consequently, Conrail continued to lose money, and an additional $1.2 billion in federal loans was authorized in 1978. The Rock Island failed in March 1975 and the Milwaukee Road filed for bankruptcy in December 1977. Under the Milwaukee Railroad Restructuring Act of 1979 and the Rock Island Railroad Transition and Employee Assistance Act of 1980, $225 million in new loans and loan guarantees were authorized for maintaining essential rail operations and employee protection. The financial stability of the rail industry was far from being restored as envisioned when Congress passed the 4-R Act.

In 1978, the ICC determined that railroads required a rate of return of 10.6 percent in order to attract the private investment capital that would allow them to properly maintain and renew plant and equipment. In that year, only three major railroads earned more than 7 percent, none more than 9 percent. For the industry as a whole, the rate of return for the twelve months ending September 30, 1978 fell to 0.24 percent—the lowest 12-month return in railroad history.

As Association of American Railroads' (AAR) official Richard E. Briggs explained:

From 1974 through 1978, the railroads produced three times as much freight service as they did from 1932 through 1936. Yet their recent average operating income before interest payments was only 20 percent as much, mea-

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sured in constant dollars (as it was during the Great Depression).68

At a Senate oversight hearing on the 4-R Act in 1979, AAR President William H. Dempsey stated, "In the area of ratemaking reforms . . . the purposes of Congress have been thwarted—principally because of recalcitrance and poor implementation by the ICC."69

Even though Congress intended the market dominance and other rate provisions of the 4-R Act, "to inaugurate a new era of competitive pricing,"70 the ICC created three rebuttable presumptions in favor of finding that the railroad is market dominant and its rates, therefore, regulated.71 There were not countervailing presumptions for finding that market dominance did not exist.

The presumptions of market dominance were: 1) when a railroad handles 70 percent of involved traffic, 2) when the rate exceeds variable cost by 60 percent, or 3) when a shippers has made a substantial investment in rail-related equipment or facilities.

Initially, private carriage and potential geographic or product competition72 were not considered in applying the 70-percent market-share presumption, even though these are all recognized parts of economic life. In 1979, the ICC, citing a "misunderstanding," agreed to do so.73 The 60-percent-over-variable-cost presumption was used as a rate ceiling to "impede railroad pricing even more than was the case prior to the 4-R Act," argued Mr. Dempsey.74

The ICC interpretation of the 4-R Act was that if a railroad had discretionary power to raise rates, it had market dominance.75 As much as

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72. Product competition refers to the ability of a shipper or consignee to use a substitute for the involved commodity.
74. Senate Transportation Subcommittee, February 7, 1979.
75. As was the case before the 4-R Act, few railroads lowered rates. The reason was fear that when market conditions changed they would be prevented by regulators from raising them even to the pre-reduction level; and that other regulations, requiring rates to be equal over competing routes, would force them to lower rates other than the ones intended, even when market conditions differed among the routes. Railroad rates prior to the Staggers Rail Act bore little relationship to economic reality. They were mostly the product of "historical accident." C.
three-quarters of all rail traffic was thus considered “market dominant” by the ICC—despite the existence of an ICC-ordered consultant’s study (ignored by the Commission) that concluded only 10 to 15 percent of all rail traffic was market dominant. According to a 1975 report by the Bureau of the Census, truck transportation was dominant in twenty-three of twenty-eight states surveyed.

Observed transportation consultant Richard J. Barber in 1979:

There is something utterly unreal about a situation in which the rail share of total intercity tonnage carried has fallen to 26.6 percent . . . and the rail rate of return has fallen almost to zero, yet the ICC decrees that for one-half to three-fourths of their traffic the railroads are “market dominant.”

Even though the rail industry was demonstrably revenue inadequate, and even despite Congress’ concern for rail revenue adequacy as evidenced by language in the 4-R Act, the ICC adamantly refused to consider revenue adequacy as anything more than “one important factor” among many.

Unlike heavily regulated—and market protected—electric utilities, railroad markets were subject to intense competition from less regulated motor-carrier and barge operators—competitors whose rates of return on investment were 15 percent and 7 percent, respectively, while railroads were posting returns of less than 3 percent throughout the 1970s.

VI. THE BRIGHT SIDE

Enacted in an atmosphere of hopeful expectations, the 4-R Act did little to lift from the railroads the gloom of despair.

A study by the Federal Railroad Administration—mandated under the 4-R Act—concluded that the railroads’ financial situation would only worsen in time. Indeed, three years after passage of the 4-R Act, much of the railroad industry remained mired in substandard earnings.

Conrail was still swimming in a rising sea of red ink. The Rock Island

Barnekov, Regulation Magazine. Barnekov explains that because of the lengthy and costly regulatory burden railroads had to overcome in order to adjust rates, rail pricing typically resorted to across-the-board general rate increases as costs rose. As a result, the rail rate structure tended to reflect cost patterns that existed decades earlier, ignoring changes in technology and traffic flow that had significantly altered those cost patterns.

76. The Impact of the 4-R Act Railroad Ratemaking Provisions, I.C.C., (October 5, 1977) at 42.
81. Internal Memorandum, E&F, AAR, supra note 13.
82. Id. at 22.
virtually ceased to operate during the summer of 1979, with the Kansas City Terminal Railroad providing federally funded "directed service" over Rock Island lines using Rock Island employees.\textsuperscript{83} By the fall of 1979, the Milwaukee Road had exhausted its cash.\textsuperscript{84}

Despite record traffic levels for 1979 (914 billion ton-miles, with strong increases in grain and coal loadings), the railroad industry's rate of return on investment increased to only 2.93 percent.\textsuperscript{85} By contrast, federally insured certificates of deposit were yielding in excess of 11 percent during 1979.

However, the 4-R Act did prove that regulatory reform could be achieved in Congress—The 4-R Act being the precursor of extensive deregulation in the transportation industries. Domestic airline transportation was deregulated in 1978.\textsuperscript{86} In mid-1980, the Motor Carrier Act was passed, which virtually removed entry, exit and most rate controls for truckers.\textsuperscript{87} The Staggers Rail Act became law in the fall of 1980. The Northeast Rail Services Act of 1981 exempted Conrail from the more restrictive line-abandonment provisions of the Interstate Commerce Act. And, the Bus Regulatory Reform Act of 1982 deregulated interstate bus transportation.\textsuperscript{88}

The 4-R Act had begun this process by recognizing that railroads—like all other businesses—require the opportunity to earn a rate of return on investment equivalent to the current cost of capital.\textsuperscript{89}

The 4-R Act also established that railroads should not be prevented—by bureaucratic delays—from adjusting rates in competitive markets so that they can compete effectively.

Finally, the 4-R Act recognized that some rail movements need not be subject to regulation at all. In 1979, the Commission used authority it had received under the 4-R Act to exempt from regulation the rail movement of fresh fruits and vegetables.\textsuperscript{90} The movement of fresh produce by truck had never been subject to economic regulation; and by 1977, the rail share of this traffic moving in truck-competitive piggyback service had virtually disappeared, falling to 0.2 percent.

Freed to compete, the railroads began to gain a market share of this

\textsuperscript{84} Rowe, supra, note 64 at 22.
\textsuperscript{85} Internal Memorandum, E&F, AAR, supra note 13.
\textsuperscript{89} Economists describe the cost of capital as the opportunity cost of funds. The opportunity cost of funds is the income that is foregone because the funds cannot be used elsewhere. If any business is to survive in the long run, its revenues must cover its current cost of capital. If the investor cannot earn the current cost of capital, he will transfer the capital to some other use.
\textsuperscript{90} Ex parte 346, Sub. 1; 361 I.C.C. 211.
commodity. By 1980, the rail share had climbed to 1.4 percent; in 1984 to 5.9 percent; and in 1986 was 6.2 percent.\footnote{Office of Transportation, U.S. Department of Agriculture.} Railroads use their new economic freedoms to establish market-sensitive rates and services.

VII. THE STAGGERS RAIL ACT

The Staggers Rail Act of 1980 permitted the dynamics of market forces to operate in the railroad industry.

In passing Staggers, Congress made a series of findings\footnote{House Report 96-1430, 96th Cong., 2d Sess. (1980) at 3.} confirming what railroad officials had been maintaining for more than a decade: 1) most transportation in the U.S. is competitive, 2) nearly two-thirds of the nation’s intercity freight is transported by modes other than rail, and 3) failure to achieve increased earnings within the rail industry will result in either further deterioration of the rail system or the necessity for additional federal subsidy.

Some of the goals\footnote{Id. at 24.} of Staggers were to assist the industry in its rehabilitation under private ownership; to reform federal regulatory policy to preserve an efficient, economical and financially stable system; and to provide the regulation necessary to balance the needs of carriers, shippers and the public.

As the Edison Electric Institute astutely observed:

\ldots regulators must balance their efforts to keep down immediate consumer costs against the even more important responsibility to assure adequate (service). \ldots Restrictive and erratic regulation has increased investor risk while holding returns below those offered by such investments as money-market funds, savings certificates and some government securities.\footnote{Statement of Claire V. Hansen of Edison Electric Institute as published in The Washington Post, Feb. 14, 1882.}

Under the Staggers Act, railroads were to enjoy the market freedoms necessary to seek adequate revenues in the competitive marketplace—freedoms long available to rail-competitive truck and barge operators, as well as to virtually all other industries.

The intent of Staggers—as with the 4-R Act before it—was not a promise of prosperity for the railroads. Staggers did not promise long-term survival of any particular railroad, nor did it guarantee that the railroads would reach revenue adequacy. Staggers gave the railroads only an opportunity for survival—within the framework of the competitive marketplace.

Signed into law by President Carter on October 14, 1980, Staggers built upon the framework of the 4-R Act by making nine fundamental regulatory changes:
1) Demand and competition were to be the principal regulators; regulation of maximum rates was to continue only where an absence of effective competition exists.  

2) Where the Interstate Commerce Commission retains jurisdiction of rail rates, it must take into consideration the revenue adequacy of a railroad in determining whether or not a rate is "reasonable." (Although the Commission has emphasized that absence of revenue adequacy will not, in itself, guarantee approval of a rate.)

3) A rail cost recovery index—to measure the impact of inflation on railroad—was mandated. It permits quarterly rate changes to offset the increased costs of labor, materials and supplies, and is called the Rail Cost Adjustment Factor (RCAF).  

4) The ICC was to relinquish jurisdiction over minimum rates that contribute to going-concern value.  

5) Compelling routes and services could be priced differently, to reflect the demand for each.  

6) Like every other business, railroads were permitted to enter into confidential contracts with their customers—contracts which, among other factors, could cover a guaranteed volume of freight for a specified time and with a guaranteed level of service.  

7) Collective ratemaking was effectively abolished. Railroads can no longer collectively discuss single-line rates, and discussion on joint-line rates was limited to railroads that directly connect.  

8) The power of the Commission to authorize exemptions from regulation was expanded to all cases where regulation was not necessary to carry out the National Transportation Policy and the matter exempted was of limited scope, or regulation was not needed to protect shippers from an abuse of market power.  

9) States were required to conform their standards for intrastate rail regulation to those used by the ICC.  

Congress was aware that the ICC had previously thwarted (under the 4-R Act) directives to permit railroads greater freedom to raise and lower

96. 49 U.S.C. 10701a (b) (3) and 10704 (a) (2) (1978).
98. 49 U.S.C. 10701a (c) (1) and (2) (1978).
99. 49 U.S.C. 10741 (e), (f) (3) and (f) (4) (1978).
100. Ex parte 358-F; 361 I.C.C. 205. In 1978, the ICC—for the first time—announced it would look favorably upon rail shipper contracts—so long as they were open for public inspection. Previously, rail contracts were prohibited for fear they would weaken the common-carrier concept. Only a handful of contracts were signed—most shippers fearing that to do so would mean disclosure to their competitors of market volumes, supply sources, and transportation costs; some railroads were wary that the ICC's decision might be overturned by the courts. It was not until confidential contracts were permitted that shippers and carriers embraced them, as will be explained.
rates. Recall that the Commission had found that in almost every case in which the railroads had discretionary power to raise rates, the railroads possessed market dominance.

Unwilling to trust subjective measures of market dominance, Congress required that a carrier cannot be found market dominant if the rate is below a specific revenue-to-variable-cost percentage. (The ratio began at 160 percent in 1980 and rose, by 1985, to 180 percent—where it remains.)\(^\text{105}\) Similarly, tough standards for suspending rates pending investigation of their lawfulness were enacted.

Additionally, both abandonment and merger proceedings were expedited and shippers wishing to keep noneconomic lines open were granted new powers to acquire or subsidize those lines. Otherwise, the standards of the 4-R Act relating to abandonment and merger essentially remained unchanged.

Finally, the Railroad Accounting Principles Board was authorized to "establish principles governing the determination of economically accurate railroad costs."\(^\text{106}\) Due to a delay in Congressional funding, the Board did not begin its work until 1985 and was in the process of providing a final report as of this writing.

VIII. THE RECORD SINCE STAGGERS

Railroad earnings have not improved since passage of the Staggers Act. Railroads survived the recession of 1981-1982—and continue to survive today—because of reductions in operating costs, because of extraordinary cash-flow benefits stemming from a 1981 tax-law change, and because of reduced equipment purchases.

In fact, earnings—when adjusted for inflation—actually have declined since Staggers and have taken a precipitous drop during the past two

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\(^{105}\) The ICC subsequently established additional guidelines for determining whether or not railroads are market dominant. The existence of rail-to-rail competition and rail-truck or rail-barge competition are to be considered, as well as product and geographic competition. The U.S. Fifth Circuit Court of Appeals, \textit{en banc}, subsequently upheld the legality of these guidelines. The result has not been a virtual "blank check" to railroads to raise rates and "gouge" shippers, as will be shown.

Of 82 market dominance cases so far decided at the ICC (by administrative law judges, review boards or the full Commission), 65 have been in favor of the shipper. And, of 57 rate reasonable cases—following a finding of market dominance—so far decided at the ICC (by administrative law judges, review boards or the full Commission), 21 decisions have been in favor of the shipper. In two decisions, Burlington Northern Railroad was ordered by the full Commission to refund to two coal shippers a total of $57.9 million, plus interest. Western Coal Traffic League v. U.S., 719 F.2d 772 (1983), \textit{cert. denied}, Western Coal Traffic League v. U.S., 104 S.Ct. 2160 (1984); San Antonio Public Service v. Burlington Northern et. al., Case No. 36180; and Omaha Public Power District v. Burlington Northern, Case No. 38783.

\(^{106}\) 49 U.S.C. 11161 and 11162.
years.\textsuperscript{107} Inflation-adjusted net railroad operating income (NROI) for 1986 is 31 percent below its 1980 level—and in no year since 1980 has NROI exceed its 1980 level.\textsuperscript{108} NROI reflects net after-tax income attributed solely to rail operations, exclusive of interest, other fixed charges and special charges related to employment reductions and one-time equipment write-downs.

\begin{table}[h]
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\begin{tabular}{lccccccc}
\hline
\hline
NROI (billions) & $1.3$ & $1.2$ & $0.6$ & $1.1$ & $1.3$ & $1.0$ & $0.9$ \\
Index ($1980 = 100$) & 100 & 92 & 46 & 85 & 100 & 77 & 69 \\
\hline
\end{tabular}
\caption{NROI since 1980 (Adjusted for Inflation)}
\end{table}

Other measures of financial performance paint a similar picture. For example, when measured by the basic test of long-run economic viability—a return on net investment equivalent to the current cost of capital—the rail industry’s problems remain pressing.

For the years 1981 through 1986, the industry’s rate of return on net investment (ROI) sharply trailed the industry’s current cost of capital.\textsuperscript{109} After reaching a high of 4.7 percent in 1984, ROI again began falling. On a comparable accounting basis, profitability has fallen below the 4.2 percent posted in 1980 and is only slightly better than the 2.9 percent recorded in 1979.

\begin{table}[h]
\centering
\begin{tabular}{lccccccc}
\hline
\hline
ROI & 4.2\% & 4.0\% & 2.1\% & 3.6\% & 4.7\% & 3.6\% & 3.5\% \\
Cost of capital & 12.1 & 16.5 & 17.7 & 15.3 & 15.8 & 13.6 & N/A \\
\hline
\end{tabular}
\caption{Return on investment vs. cost of capital}
\end{table}

\textsuperscript{107} Internal Memorandum, E&F, AAR, supra note 13. Using Retirement-Replacement-Betterment (R-R-B) method of accounting, the only comparable method available for the years 1980-1986. Calculations exclude special charges related to employment reductions and one-time equipment write-downs.

\textsuperscript{108} Id. at 28.

\textsuperscript{109} Return on investment (ROI) figures from E&F, AAR; cost of capital figures from I.C.C. proceedings ex partes 415, 436, 458 and 464, respectively. On a depreciation accounting basis (under which the railroads were placed in 1983), returns for 1983, 1984, 1985 and 1986 were 4.3 percent, 5.7 percent, 4.8 and 4.1 percent, respectively. Special charges for employment reductions and equipment write-downs also excluded.
The railroads' return on shareholders' equity, meanwhile, has been eroding and is woefully deficient when compared with that of the electric utility industry or all of American industry:110

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<tbody>
<tr>
<td>Elec. Utilities</td>
<td>10.7%</td>
<td>12.4%</td>
<td>13.2%</td>
<td>14.3%</td>
<td>14.9%</td>
<td>14.4%</td>
<td>N/A</td>
</tr>
<tr>
<td>Railroads</td>
<td>6.0</td>
<td>10.5</td>
<td>5.4</td>
<td>7.3</td>
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<td>All Industry</td>
<td>14.4</td>
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(The industry's change to depreciation accounting in 1983 makes the years 1983-1986 not comparable with prior years.)

The stock market similarly reflects the fact that rail earnings continue to lag those of most American industry. Since 1980, the Standard and Poor's (S&P) Rail Index has dramatically underperformed other stock indicators, with the S&P Electric Utility Index increasing almost four times faster than the rail index, and both the Dow Jones (DJ) Industrial and Transportation Indices advancing about three times as fast.

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<td>+114%</td>
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In short, rail earnings have not improved since Staggers and remain well short of what the industry needs for long-term viability and what other industries are achieving.

However, the marketing freedoms bestowed by Staggers permitted the railroads to weather the deep recession of 1981 and 1982—the longest and deepest since the Great Depression—without a bankruptcy. Prior to Staggers, a recession of such a magnitude would have left a number of railroads bankrupt—a fact to which history attests. Staggers also provided railroads with some of the tools needed to adjust to dwindling industrial demand and immense increase in intramodal and intermodal competition.

Though rail earnings remain perilously substandard—tarring with falsehood allegations that railroads have become wealthy since Staggers' passage—deregulation has resulted in many successes.

Conrail, once a seemingly hopeless ward of the state, posted an 8.7 percent return on investment in 1984, a 6.1 percent return in 1985 and a

110. Internal Memorandum, E&F, AAR, supra note 13; for electric utilities; Moody's Utility Index; for all industry, Value Line Industrial Composite.
5.2 percent in 1986.\textsuperscript{111}

Said Conrail Chairman L. Stanley Crane after Congress voted to return the rehabilitated carrier to the private-sector, "I am convinced that we would have no Conrail to sell today without the Staggers Rail Act of 1980 . . . the nation's rail system remains a private-sector industry only because of (Staggers)."\textsuperscript{112}

Meanwhile, the previously bankrupt Milwaukee Road was pared to profitable size and, following a spirited bidding war, merged with the Soo Line Railroad. Though the Rock Island was liquidated, much of its former trackage was gobbled up in active bidding. In New England, Guilford Transportation Industries was formed out of three carriers once thought on the road to extinction—Boston and Maine, Delaware and Hudson, and Maine Central.

Staggers permitted and encouraged a more business-like approach to railroading. Since 1980, the nation's major railroads have shed more than 20,000 route miles, slimming down to a national system of just over 140,000 miles.\textsuperscript{113} Now, the railroads are doing more intensive maintenance work on downsized systems. Since 1980, Class I railroad employment has been reduced by almost 200,000, or 40 percent.\textsuperscript{114}

Some 140 short line or regional railroads have been created since 1980—versus only seventy-five during the thirty-year period preceding 1980.\textsuperscript{115} These are smaller businesses whose unique lower cost structure permits them to turn a profit where major railroads cannot.\textsuperscript{116} Short lines preserve rail service and rail jobs that otherwise would be lost, and prevent diversion of business to the highway. Their creation has significantly reduced potential railroad line-abandonment applications.

As the railroads were learning to do business in a less-regulated, more competitive environment, they also enjoyed extraordinary cash-flow benefits from two sources—the Economic Recovery Tax Act of 1981,\textsuperscript{117} and a reduced requirement for new rolling stock and locomotives.

That tax measure, in part, changed the railroads' method of accounting for tax purposes, permitting rapid depreciation of an investment base in track that never had been allowed to reflect depreciation. The so-called "frozen" asset base created by the previous retirement-replacement-bet-

\textsuperscript{111} Internal Memorandum, Consolidated Rail Corp.
\textsuperscript{112} Letter of L. Stanley Crane to Congress (Jan. 7, 1987).
\textsuperscript{113} Internal Memorandum, E&F, AAR, supra note 13.
\textsuperscript{114} Internal Memorandum, U.S. Railroad Retirement Board.
\textsuperscript{115} Internal Memorandum, American Short Line Railroad Association.
term system of accounting was allowed to be written off rapidly, using an accelerated, five-year method that provided a one-time cash flow of $2.5 billion.

Cash-flow also was improved as a result of reduced orders for new freight cars and locomotives stemming from an oversupply of privately owned freight cars, depressed business levels and improved fleet utilization. Average annual freight car installations fell from 69,000 for the five-year period ending with 1981 to 12,000 for a similar period ending with 1986.\textsuperscript{118} Average annual new locomotive installations also fell over that time period—from more than 1,100 annually to just 375.\textsuperscript{119}

Increased cash flow helped maintain unprecedented capital investment in track, yards, terminals and research. As a result, the tracks of many railroads literally were lifted out of the mud in the past decade.

In the mid-1970s, a new term was coined, "standing derailment," to describe the phenomenon of freight cars falling off collapsing track while standing still. Today, deferred mainline maintenance virtually has been eliminated, and many freight trains travel at seventy miles per hour. Railroad contracts guarantee train arrival times—many of which are competitive with the fastest motor-carrier service.

Improved track has resulted in safer operations. Since 1980, the number of train accidents has been trimmed by 60 percent, with those caused by track defects down by 63 percent.\textsuperscript{120} Observes Federal Railroad Administrator John H. Riley: "[y]ou've used that cash flow to reshape your infrastructure into a safer system, as well as a more efficient one."\textsuperscript{121}

Industry expenditures for research and development are at record levels. In slightly more than a decade, the research budget managed by the AAR jumped from under $5 million annually to almost $40 million—\textsuperscript{122} and that does not include what individual railroads and rail supply firms spend on proprietary research.

AAR research programs are seeking improved freight car design; more wear-resistant steels for track, equipment and components; applications for alternative fuels; and broader specification for residual fuels for locomotives, robot applications; a totally redesigned freight train that can reduce operating costs by as much as 50 percent; and advanced central-

\begin{footnotes}
\item 118. Internal Analysis Endorsing Staggers Rail Act, Operations and Management Department, American Association of Railroads, (May 2, 1985).
\item 119. \textit{id.} at 32.
\item 120. Federal Railroad Administration, Office of Safety, U.S. Department of Transportation, Accident Incident Bulletin No. 154 (July, 1986).
\item 122. Research & Test Department, Internal Analysis, American Association of Railroads.
\end{footnotes}
ized train control based upon computer, microwave and fiber-optic
technology.\textsuperscript{123}

Freight loss and damage claims payouts by railroads have been re-
duced dramatically. The claims payout for each $100 in freight revenue,
which was $1.83 in 1975, has been reduced to $0.46 in 1985—a 75 per-
cent reduction.\textsuperscript{124}

All things being equal, Staggers’ passage might have resulted in rail-
roads a rate of return equivalent to their cost of capital. All things rarely
are equal.

In 1980, Congress virtually eliminated entry requirements for motor
carriers, scrapped most operating restrictions and gave truckers almost
total pricing freedom\textsuperscript{125}—one result being creation of thousands of new,
low-cost trucking companies. Congress in 1982 liberalized laws as to the
maximum length, size and weight of trucks permitted on federal-aid and
Interstate Highways—without sufficient increases in user charges to cover
the full pavement damage caused by heavier axle loadings.\textsuperscript{126}

Rail-competitive motor carriers—often non-union firms—best able to
take advantage of this environment have slashed their per-mile operating
costs by as much as 28 percent since 1982.\textsuperscript{127}

Truckers, meanwhile, are lobbying for even greater size-weight liber-
alizations, permitting them to operate twin 48-foot trailers—as heavy as
134,000 pounds—nationwide. The result could reduce current rail pre-
tax net revenues by as much as 65 percent as some tonnage is diverted
and railroads reduce rates to mitigate that diversion.\textsuperscript{128}

Also, since passage of the Staggers Act, a fundamental shift in our
economy has occurred. We face greater foreign competition for manu-
factured goods both home and abroad. Energy shortages have resulted
in the downsizing of many products. We are moving from a manufactur-
ing-based—or smokestack—economy to one of greater service orienta-
tion. Since 1980, the percentage of gross national product attributable to
“goods” has fallen by more than three percentage points, while that attri-
butable to “services” has climbed by almost four percentage points.\textsuperscript{129}

Railroads traditionally have had a symbiosis with smokestack

\begin{footnotesize}
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\item\textsuperscript{123} Frank N. Winer, \textit{High Technology Helps Railroads Reduce Cost}, DEF. TRANS. J., Oct, 1986 at 24-27.
\item\textsuperscript{124} Freight Claim & Damage Prevention Division, O&M, AAR.
\item\textsuperscript{125} Motor Carrier Act of 1980, Pub. L. No. 96-296, 94 Stat. 793 (1980).
\item\textsuperscript{127} Intermodal Policy Division, Internal Analysis, American Association of Railroads.
\item Id. at 34.
\item\textsuperscript{129} Survey of Current Business, (1986); and Economic Report of the President, U.S. Depart-
ment of Commerce (1986). Between 1950 & 1980, the percentage of Gross National Product
attributable to “goods” and “services” has risen by 10 percentage points.
\end{enumerate}
\end{footnotesize}
America. But since 1980, nine of the industry's "top ten" commodities are down in terms of carloadings. For example, carloadings provided by iron ore are off by 50 percent; by iron and steel off by 50 percent; by phosphates and industrial sand off by 41 percent; by pulp and paper off by 38 percent; by lumber off by 15 percent; and by choking coal off by 14 percent.\textsuperscript{130} Overall, rail freight carloadings are down by almost 14 percent since 1980.

Railroads have responded with unprecedented cost-cutting in an attempt to replace those lost "traditional" tonnages with consumer-oriented traffic moving by truck. Various indices of productivity have increased as high as 43 percent since 1980.\textsuperscript{131} New agreements with rail labor have liberalized decades-old work rules that artificially inflated the cost of doing business.\textsuperscript{132} In 1986 alone, nationwide rail operating expenses were slashed by some 6 percent.\textsuperscript{133}

Since 1980, piggyback and container loadings have increased by 63 percent, reflecting the railroads' determination to go head-to-head with rail-competitive trucks. Margins on that traffic, however, are extremely thin, limiting its contributions to the railroads' relatively large overhead costs.\textsuperscript{134}

The one-time cash-flow benefits of the 1981 tax act have ended. With the disappearance of equipment surpluses, railroads will need to increase their freight-car and locomotive purchases to replace fleets that are subject to greater use. Omnibus tax reform legislation\textsuperscript{135} passed in 1986 is expected to have a deleterious effect on cyclical, capital-intensive industries such as railroads and some of their most important customers. Tax reform eliminates the investment tax credit, stretches out depreciation schedules and imposes a harsh new minimum tax in years of depressed earnings.

\textsuperscript{130} Interstate Commerce Commission, Freight Commodity Statistics & Carload Waybill Statistics.

\textsuperscript{131} Statistical Analysis of Class I Railroads, Economics & Finance, AAR. (For example, there was a 43 percent increase in freight revenue ton-miles per employee-hour paid, and a 41 percent increase in freight revenue ton-miles per freight-train hour).

\textsuperscript{132} Agreements reached with the United Transportation Union. (For example, give management greater flexibility in assigning work, permit all intermodal and unit-type trains to be operated with a caboos, allow new employees to be hired at 75 percent of the wage rate paid experienced workers, phase out payment to employees for certain additional tasks assigned while on duty, and where employees are paid based upon mileage traveled, the mileage figure constituting a basic day's pay is increased by 8 percent).

\textsuperscript{133} Internal Memorandum, E&F, AAR, supra note 13.

\textsuperscript{134} In 1986, a typical truckload motor carrier had average ton-mile costs of 54 cents; while many rail-competitive motor carriers had whittled the figure to about 47 cents. As truckload rates fall, reflective cost reflective cost reductions, rail rates must also decline to remain competitive.

The railroad industry surely is not wealthy today, and the future offers only elevated financial challenges.

San Francisco-Southern Pacific Corporation President Robert D. Krebs had this to say about railroad profitability:

Our other (non-rail) operations earn a rate of return that averages over 14 percent. Some of them get a rate of return in the 20s (while the railroads earn in the 2 to 4 percent range). So I have to ask myself—and I think you should ask yourself—why shouldn’t railroads have the right to expect a decent return? 136

Railroad managements are learning to think more like business people responsible for their own destiny—to probe for more efficient ways of doing business.

So long as railroads are permitted to use the tools of capitalism, much like other businesses—especially rail competitors—it is reasonable to believe that the rail industry can achieve a viable financial future. This means, at a minimum, that railroads not again be called upon to fulfill various social welfare goals—such as being the employer of last resort—and that railroads not again be required to provide preferential treatment to special interests—such as below-market rates to coal and other favored shippers or regions.

IX. STAGGERS’ EFFECT ON RAIL RATES

Market freedoms granted railroads by the Staggers Act certainly have not been used to gouge shippers. To the contrary, rail rates have compressed to meet intense competitive pressures.

From passage of the Staggers Act in October 1980 through year-end 1986, rail freight rates, adjusted for inflation, declined by 4.9 percent. 137

Under the “revenue-enhancement” provision of Staggers, 138 railroads were permitted to raise rates 6 percent per year above the inflation rate for four years (with a cumulative maximum of 18 percent), and thereafter at 4 percent without suspension or investigation by the ICC. Thus, in the first four years ending October 1984, rates could have been raised a total of 18 percent above inflation without being potentially suspended. They were not.

Increases under that authority amounted to 0.18 percent above inflation in 1981, 0.42 percent above inflation in 1982, and no increases above inflation in 1983 and 1984. 139 In both 1985 and 1986, rail rates

137. Internal Memorandum, E&F, AAR, supra note 13.
138. 49 USC 10707a (c) & (d), (1978).
139. Internal Memorandum, E&F, AAR, supra note 13.
declined.\textsuperscript{140}

Intermodal, intramodal, product and geographic competition are effectively constraining rail rates. While most terms of contracts are confidential, it is generally agreed that the great majority of contracts have resulted in rate reductions. Since Staggers' passage, railroads and their customers have entered into more than 50,000 contracts—with more than 62 percent of all rail-hauled coal (including 86 percent of rail-hauled coal that moves for export) and 63 percent of rail-hauled grain now moving under contract.\textsuperscript{141}

Contract lengths vary from a single movement to more than thirty years and cover virtually all commodities hauled by rail. The existence of contracts often assures railroads a fixed volume of traffic and spells out for shippers the obligations of railroads, such as car supply and delivery schedule, as well as the manner by which rates may change in the future.

The General Accounting Office (GAO) says that "one of the most significant changes" that deregulation brought to the rail industry is "negotiated rates."\textsuperscript{142} GAO says "considerable savings" in freight rates are available when shippers and railroads enter into contracts.

A. Coal

Coal rates traditionally have been among the lowest of all rail freight rates on both a tonnage and ton-mile basis\textsuperscript{143}—even though coal is a commodity over which the railroads are alleged to have a great deal of market power.

Average rail coal rates dropped by 2 percent in 1985 and another 2.5 percent in 1986, and are now at their lowest level since 1981.\textsuperscript{144} When adjusted for inflation, average rail coal rates dropped by 3.7 percent since 1980, and 6.9 percent since 1981.\textsuperscript{145} Reduced world oil prices, growing availability of nuclear-generated electricity, increased competition in world coal marketed and more competition among U.S. transport modes combined to put downward pressure on those rates. The rate reductions also were made possible by reduced rail fuel and labor costs.

Increases in electric utility rates, according to figures of the Edison

\textsuperscript{140} \textit{id.} at 37.
\textsuperscript{141} Internal Memorandum, E&F, AAR, supra note 13.
\textsuperscript{142} \textit{Grain Shipments: Agriculture Can Reduce Costs by Increased Use of Negotiated Rail Rates}, U.S. General Accounting Office (1987).
\textsuperscript{143} Much is made of the fact that, in some cases, the rail rate for moving coal comprises two-thirds of the delivered price. Those making that point omit the further fact that such cases involve low-value western coal being transported as far as 1,500 miles.
\textsuperscript{144} Internal Memorandum, E&F, AAR, supra note 13.
\textsuperscript{145} \textit{id.} at 38.
Electric Institute, have been considerably greater than increases in rail coal rates.\textsuperscript{146} A study by the Congressional Research Service observed the rail revenues on coal traffic since 1971 have "increased less than the rise in either the average price of coal at the mine or the average price of electricity."\textsuperscript{147}

A 1987 Department of Energy study states:

The Staggers Rail Act of 1980 helped railroads to improve their own operating efficiency and to reduce costs. Lower costs have contributed to the improved financial performance of railroads and have helped to keep increases in rail rates relatively small.\textsuperscript{148}

Assistant Energy Secretary William Vaughan in 1985 told an audience of coal executives that:

Our analysis to date tells us that the railroads have not imposed excessive rates on coal since the passage of the Staggers Act . . . it appears that the market-oriented principles involved in the Staggers Act are contributing to the improved financial and operational health of the nation’s railroads.\textsuperscript{149}

In a report prepared for the Environmental Protection Agency,\textsuperscript{150} it was concluded, "... there is little evidence to suggest that deregulation is leading to widespread increases in rail rates above the underlying costs."

According to the ICC, 75 percent of rail coal traffic—measured both in carloads and tons—is priced below the 180 percent revenue-to-variable-cost threshold established by Staggers as possible evidence of market dominance.\textsuperscript{151}

\section*{B. AGRICULTURAL PRODUCTS}

A study of the seven largest grain-hauling railroads (which originate some 78 percent of rail grain traffic) revealed that the price of shipping grain by rail dropped more than 28 percent since Staggers’ passage.\textsuperscript{152} When adjusted for inflation, the rate reduction exceeds 44 percent.\textsuperscript{153} These reductions mainly are due to contract rates, the expanded use of

\textsuperscript{146} For example, from Staggers’ passage in October 1980 through the third-quarter 1986, the average price of a kilowatt hour of the electricity increased by 48 percent, or 1.7 times greater than the 28 percent increase in average rail coal rates.


\textsuperscript{148} \textit{Effects of Railroad Regulatory Reform on Coal and Electricity}, U.S. Department of Energy (May, 1985 draft).

\textsuperscript{149} William Vaughan, presentation of DOE and Coal Transportation, before American Minig Congress Coal Convention (1985).

\textsuperscript{150} \textit{Transportation Rate Assumptions for Coal Market Forecasting}, ICF, Inc., (1984).

\textsuperscript{151} \textit{1984 Rail Waybill Sample, costs determined on basis of Rail Form A.}, Interstate Commerce Commission, U.S. Government Printing Office.

\textsuperscript{152} \textit{Annual Railroad Grain-Rate Survey, E&F, AAR}.

\textsuperscript{153} \textit{Id. at 40}.
lower cost unit trains and a generally more competitive environment in the wake of Staggers.

A Department of Agriculture study\textsuperscript{154} found substantial evidence of innovations in rail rates and service that benefited agriculture, including small agricultural shippers. The study found strong intermodal and intramodal competition in the grain-transport markets.

Two Kansas State University agricultural economists observed: Deregulation has substantially weakened rate-bureau dominance in rate matters and has enhanced individual initiative. A good deal of action/reaction ratemaking activity among railroads occurred when the Staggers Act rules were initiated. The activities of the railroads in the Central and Upper Great Plains . . . have been characterized as 'especially innovative' and providing 'significant reduction in traditional single car rates.'\textsuperscript{155}

C. PIGGYBACK AND CONTAINER TRAFFIC

Since the Interstate Commerce Commission totally deregulated this intermodal traffic in 1981, its growth has been phenomenal. The number of loaded trailers and containers carried by rail has increased by more than 60 percent—from just over 3 million in 1980 to more than 5 million in 1986.\textsuperscript{156} In terms of carloadings, piggyback and container traffic is now second only to coal—accounting for 16.8 percent of total rail carloadings in 1986.\textsuperscript{157} Total deregulation of this class of traffic—as with fresh fruits and vegetables in 1978—has permitted railroads to diffuse pricing responsibility to market managers who, working with salesmen in the field, can arrange a competitive transportation package within minutes, literally on the shipper’s doorstep.

X. NEGOTIATIONS SOLVE PROBLEMS

Almost 100 years of stringent economic regulation cannot be liberalized without some difficulty. Problems between railroads and shippers, as well as among railroads, have occurred—although their frequency and magnitude have been less than expected when the Staggers Act was passed. The problems that have occurred are being solved—for the most


\textsuperscript{156} O&M, AAR, supra, note 15, at 40.

\textsuperscript{157} E&F, AAR, supra, note 13, at 40.
part—through negotiation rather than through administrative or court proceedings.

For example, Staggers contained a "savings clause" that permitted shippers to challenge the reasonableness of rates already on file with the ICC when Staggers was passed. Shippers filed 864 complaints, with 772 subsequently dismissed at the complainants' request—the preponderance because of negotiated settlements.

Responding to areas of unrest among certain shippers in the wake of Staggers, the ICC opened a proceeding in 1984 that is best characterized as a town meeting designed for an airing of grievances.

Two problem areas identified as deserving detailed examination were 1) the cancellation of through routes, joint rates and reciprocal switching by individual railroads ("competitive access" issues); and 2) the ICC's recognition of product and geographic competition in market-dominance determinations. Subsequently, the ICC reopened its market-dominance proceeding with respect to the consideration of product and geographic competition, and established a second proceeding to consider competitive-access issues.

The Commission urged railroads and shippers to attempt negotiated settlements—and agreements were reached on both these issues, with the ICC subsequently adopting them in rulemakings.

A. PRODUCT AND GEOGRAPHIC COMPETITION

The ICC's decision to consider product and geographic competition was upheld as sound by the full U.S. Fifth Circuit Court of Appeals (discussed earlier). Unrest continued among a number of shippers. According to James E. Bartley, executive vice president of the National Industrial Transportation (NIT) League—the largest and most diverse shipper organization in the nation—"Shippers were placed in the very difficult position of trying to show that these types of competition did not exist.""163

In March 1985, the AAR, NIT League and the American Paper Institute (API) announced agreement on revised standards for resolving disputes respecting market dominance. Stated Roy Olson, vice president, transportation, for API:

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159. In the remaining 92 cases, 61 decisions—some in favor of railroads, some in favor of shippers—were handed down; 10 were dismissed on motion of defendant railroads; and 21 remain pending for various reasons.
162. Standards for Intermodal Rail Competition, Ex Parte 445.
163. Interview with James E. Bartley, Executive Vice President of the National Industrial Transportation League.
The proposed rules will help to present misapplication of elements of geographic or product competition and better ensure railroad rate and service protection to shippers and receivers.\textsuperscript{164}

A key point in the agreement is the requirement that in all cases the burden of proving the existence of effective product or geographic competition rests with the railroads.

As to product competition, the ICC is to consider the substitutability and availability of alternative products and the relative costs of using alternatives—with respect to both the receiver and producer.

As to geographic competition, the ICC is to consider the number and accessibility of alternative sources of supply or alternative destinations, customer access to different carriers, relative transport costs of alternatives, operational and economic feasibility of alternatives, and evidence of long-term supply contracts made before passage of Staggers. The ICC adopted this agreement, with minor modifications, in October 1985.\textsuperscript{165}

\textbf{B. COMPETITIVE-ACCESS}

Shipper problems concerning competitive-access issues revolved around the cancellation by railroads of through routes, joint rates and reciprocal switching—as well as the establishment by the ICC of such routes and rates and other Commission actions when conflicts arise.

Cancellations are motivated by railroad desires to gain pricing independence—the right to set the rates for their own portion of a multi-carrier move. Independent pricing ensures price competition; and allows railroads to increase traffic density, eliminate inefficient routes and alter the manner in which revenues from a joint rate are divided among the participating railroads. The cancellations also were motivated by the demise of collective reratemaking.

As two Conrail executives pointed out:

The access issue is, in part, a stepchild of deregulation, which provided railroads with an expanded ability to dislodge themselves from the involuntary and uneconomic system of equalized joint rates, prescribed divisions, and below-cost switching charges. For the first time, carriers could price their services in accordance with cost and market demand.\textsuperscript{166}

In its deliberations on Staggers, Congress expressed concern that existing joint-rate agreements provided some connecting railroads with inadequate revenue divisions and that there was a proliferation of uneconomic routes.\textsuperscript{167}

\textsuperscript{165} Product and Geographic Competition, supra note 161.
\textsuperscript{167} House R. Conf. Rep. No. 96-1430, 96th Cong., 2d Sess., at 111.
Regulation prior to Staggers required equalized pricing over a multiplicity of routes, regardless of efficiency or costs. Competing railroads generally equalized rates at levels intended to be high enough to cover costs over even the least efficient routes.

According to Sam Hall Flint, retired vice president of Quaker Oats, his traffic department once calculated that between Little Rock and Detroit, there were 4.7 million different rail routes.\(^\text{168}\) Obviously, the costs of, and demand for, service over all of those routes were not the same—especially the one via Los Angeles.

While railroads cancelling through routes, joint rates and reciprocal switching arrangements said that the actions were necessary to improve economic efficiency, some affected shippers complained that the cancellations unjustly eliminated their routing and pricing alternatives. According to Mr. Bartley, "To realize the Staggers Act goals of a market-disciplined industry, steps had to be taken to address the problem created by the declining number of major competitors in the railroad industry."\(^\text{169}\)

In January 1985, the AAR and NIT League joined hands and reached a settlement on competitive-access issues, while a second settlement with the Chemical Manufacturers Association (CMA)—generally consistent with the earlier NIT League agreement—was reached in March 1985. In September 1985, the ICC adopted, with some modifications, these agreements.\(^\text{170}\)

The new rules require railroads to provide notice and justification for cancellations; require an attempt at a negotiated settlement before ICC involvement; and require the Commission to suspend and investigate cancellations if a complaining shipper has or would use the rate or route for a significant portion of current or future rail needs, and the cancellation would eliminate effective rail competition.

Additionally, the rules provide for the ICC to eject a cancellation or prescribe a through route, joint rate or reciprocal switching if it finds such action necessary to prevent anti-competitive behavior. The existence of product competition will not be considered in these proceedings, while railroads will bear the burden of proving the existence of geographic competition.

Not all shippers are satisfied. A few continue to seek a legislated remedy that would force railroads to open their privately owned tracks (the railroads' factory) for use by others at rates to be established, ulti-

\(^{168}\) Address by Sam Hall Flint, Vice President of Quaker Oats Corp. (retired), Southern Traffic League (Sept. 11, 1984).

\(^{169}\) Interview with James E. Bartley, supra note 163, at 44.

\(^{170}\) Intramodal Rail Competition, 1 I.C.C. 2d 822, 823 (1985).
mately, by federal courts.\textsuperscript{171} Railroads would be subject to dual regulation—by both the Interstate Commerce Commission and federal courts, subjecting them to a regulatory nightmare affection no other American industry.

The proposed legislation would seek to create new principles of anti-trust law specifically aimed at railroads—to force railroads to open their plant to use by others or face antitrust penalties. The railroads see this as an unjust taking of private property—a taking without adequate compensation (under the principle controlling in condemnation proceedings) because the purpose of the legislation clearly is to force many rail rates to levels that would not cover the full costs of the service demanded.

While a technical discussion of railroad economics is beyond the scope of this article, it should be recognized that over much of the railroads' lines—and certainly on a system basis for all major railroads—economies of density exist.\textsuperscript{172} This means that the cost of moving each additional carload (marginal cost) is somewhat less than the average of moving all carloads (average cost). Any requirement that rail rates be forced to the level of marginal costs is a prescription for railroad bankruptcies.

\section*{C. Confidential Contracts}

As explained earlier, one of the most successful provisions of the Staggers Act was the ability of railroads to enter into confidential contracts with their customers.

Some grain, soybean and sunflower-seed shippers,\textsuperscript{173} however, sought greater regulatory protection through increased public disclosure of contract terms. They maintained that contract confidentiality prevents their right—under Staggers\textsuperscript{174}—to obtain contract rates and services substantially similar to those of a competitor. Other grain, soybean and sunflower-seed shippers, however, strongly supported continued contract confidentiality.

In October 1985, following negotiations with the National Grain and Feed Association—which represents some 1,250 grain and feed compa-

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{171} S. 443, and H.R. 941, 100th cong., 1st Sess. (1987).
\item \textsuperscript{172} T. Keeler, Railroads, Freight and Public Policy, (Brookings Institution, 1983), at 43-48; \textit{see also} A. Kahn, The Economics of Regulation II, (1971), at 116-126.
\item \textsuperscript{173} All farm products except grain, soybeans and sunflower seeds are exempt from economic regulation.
\item \textsuperscript{174} Section 10713 of Staggers permits the ICC to make public certain contract information to afford shippers the ability to challenge a contract on the grounds that it will impair the ability of the contracting railroad(s) to meet their common-carrier obligations to the complainant (Section 11101). Agricultural shippers only (Section 10713(d)(2)(B)(i)) may challenge a rail contract on the grounds that the contracting railroad has refused to enter into a substantially similar contract with them, or that the contract constitutes a destructive competitive practice.
\end{itemize}
\end{footnotesize}
ries—the railroads agreed on more explicit contract-disclosure rules affecting raw grains and soybeans. The agreement, like those with the NIT League, API and CMA was submitted to the ICC for adoption—which expanded it in many ways, neither contemplated nor desired by the railroads or many shippers. Because of this, the ICC sought another round of public comment.

In the interim, as part of the October 1986 Conrail Privatization Act, Congress directed the ICC to liberalize its contract-disclosure rules as they affect shippers of grain, soybeans and sunflower seeds.\textsuperscript{175}

To meet Congress’ timetable, the ICC issued interim rules\textsuperscript{176}—effective January 22, 1987—that went beyond the minimum additional disclosure ordered by Congress. The ICC also sought additional public comment before making the new rules final. (As of this writing, final rules have not been issued.)

A sizeable segment of the agricultural community opposes greater contract disclosure. A coalition of major grain shippers say that “a small but vocal minority of the agricultural community” has been “unwilling to make the commitment necessary to realize the full benefit of rail contract transportation.”\textsuperscript{177}

At the ICC, a survey was taken among small, medium and large grain, soybean and sunflower-seed elevator operators, along with representative feed mills and grain marketing firms. A major conclusion was:

Many small country elevators are disadvantaged by the high-volume railroad contract rates of competing larger elevators. However, even if contract rates were not available, these small elevators would still be disadvantaged by the existing railroad tariff rate structure which provides substantially reduced rates for the larger multiple car and unit-train shipments.\textsuperscript{178}

Lack of volume was most often cited as a reason for not having a contract. Many elevator operators claiming to be disadvantaged had refused to make investments in volume loading facilities, even though they had invested to otherwise enlarge their facilities to handle increased government-subsidized grain storage.

The survey made clear that, overall, farmers have benefited from

\textsuperscript{175} Omnibus Budget Reconciliation Act of 1986, Pub. L. No. 99-509, 100 Stat. 1910, SS. 4051. Congress ordered the I.C.C. to ensure that, at a minimum, the following information be disclosed on certain agricultural-shiffer contracts: identity of the shipper as well as specific origins, destinations and transit points; the duration of the agreement; volume requirements; the date the service began; and the date the contract became applicable.


\textsuperscript{177} Grain Shippers Ask I.C.C. to Delay Contract Rules, \textit{DAILY TRANSPORTATION REPORT} (Dec. 4, 1986).

confidential rail contracts through higher prices being paid them for their harvest. Indeed, it is common for farmers to truck large quantities of grain to more distant, high volume elevators in search of higher prices for their grains, soybeans and sunflower seeds.

XI. POSITIVE PERCEPTIONS

In a nationally syndicated column, economics writer Warren Brookes observed that, "In short, the Staggers deregulation has been a monumental success, restoring the once bankrupt U.S. railroad industry to modes profitability, while benefiting shippers and consumers with more competitive rates." 179

ICC economist Christopher Barnekov suggest that the benefits of deregulation are so widely disbursed and that the beneficiaries are so busy minding their own businesses that they have not sought out media attention or traveled to Washington to tell their story. 180 Dr. Barnekov states: "It is not in most companies' interests to reveal to their competitors (or their customers) how much their logistics costs have fallen."

A few very vocal special-interest pleaders—those who believe they could gain greater competitive advantages themselves under continued strict economic regulation—have amplified their voices through various coalitions. However, even the most critical opponents of Staggers Act freedoms have been unable to point to any railroad abuses since passage of the Act. 181 Complaints are based upon fear—fear that in a less regulated environment abuses might occur.

Electric utility interests—clearly the most vocal of special interests opposing railroad market freedoms—have, in fact, acknowledged significant transportation-dollar savings flowing to them since Staggers. A survey identified many electric utility press releases, annual reports and public comments crediting negotiated rail-transportation contracts—all growing out of Staggers—with saving utility customer's millions and even hundred of millions of dollars. 182

A December 1986 nationwide random sample of rail shippers reveals that 72 percent of those polled view railroads—since passage of the Staggers Act—more dependable in keeping schedules, more responsive to customer needs and concerns, and more reliable in

179. C. Barnekov, A Look at Two Faces of Railroad Regulation, 7 TRAFFIC WORLD 207 (Aug. 18, 1986), at 86, 89; R.V. Delaney, printed remarks before the National Industrial Transportation League (Nov. 10, 1986).
180. Id. at 49.
181. At the ICC 1984 "town meetings," described earlier, shippers were unable to offer a single example of ratemaking abuse, even though the ICC proceeding was instituted as a forum for them to do so.
182. Information and Public Affairs Department, American Association of Railroads.
performance.\textsuperscript{183}

In a \textit{Wall Street Journal} opinion article, a former general counsel of the ICC and an assistant to a current ICC commissioner wrote:

The new law seems to be working as intended. Staggers was enacted because the existing regulatory scheme had failed conspicuously . . . problems are those of bad communication rather than commercial oppression.\textsuperscript{184}

Said Senator John C. Danforth, chairman of the Senate Commerce Committee until 1987, "I don't believe that the Staggers Act should be altered. It's been the salvation of the railroads."\textsuperscript{185}

A former vice chairman of the Civil Aeronautics Board, who is currently dean of the Graduate School of Industrial Administration at Carnegie Mellon University, observed:

Perhaps the chief benefit of deregulation is that it has increased efficiency substantially. Under regulation, there was little incentive to plan or to pinpoint the sources of markets that were successful and those that were failure, or to keep costs under control and be responsive to consumer demands.

In contrast, deregulation is leading to substantially more efficient industries, in which cross-subsidy is absent, a diversity of price-service options is present, and cost-minimizing behavior is prevalent, both in delivery systems and in other operation costs.\textsuperscript{186}

Concerned that a small minority of disgruntled shippers might cause the Staggers Act to be amended so as to insulate special-interest groups from workings of the marketplace, a shippers group has been established to oppose any changes to Staggers.

The Committee Against Revising Staggers (CARS) is made up of more than 300 shippers from each of the contiguous states and the District of Columbia—self-described as large and small, bulk and non-bulk, captive and non-captive.

Some of the larger members of CARS include the American Retail Federation, Archer Daniels Midland, Bethlehem Steel, Carnation, Continental Grain, Crown Zellerbach, General Motors, Georgia Pacific, Kennecott, Procter and Gamble, Quaker Oats, and Sears. Stated CARS in a press release:

Staggers has been the one leading factor contributing to the financial revival of the American railway system and saving consumers millions in transportation costs during the last four years.

\textsuperscript{183} Hamilton, Frederick & Schneiders, A nationwide Survey of Opinions of Upper-Income individuals and Shippers Toward America's Freight Rail Industry (public opinion research under contract to AAR.) (Jan., 1987).


Stanton P. Sender, a CARS organizer and transportation counsel for Sears, observed:

Staggers is working as intended for the shippers and consumer. The efficiency and reliability of shipping goods by rail has improved dramatically since 1980, thus holding down shipping costs which would be passed along to the public.187

In June 1985, the Transportation Investor Roundtable—a nationwide group of investor executives—issued a statement warning:

We believe that the threat of changes in the Staggers Rail Act, or even the fine-tuning of the Act, could quickly destroy today’s renewed confidence in the industry. Without his confidence, the economy as well as the nation’s competitive position in world markets would be at risk from a weakening of its railroad structure.188

Fifty-six economists—including two Nobel laureates, former members of the President’s Council of Economic Advisers, three past presidents of the American Economic Association, and many well-known authors—have gone on record in support of Staggers.

In a jointly signed letter, they stated:

. . . the Staggers Act has brought about a regulatory regime much more attuned to the state of competition than now exists . . . was part of a broad, long-term effort to eliminate inefficient economic regulation . . . (that) has often failed to serve the interest of the public at large.189

Other major supporters of Staggers include the Grocery Manufacturers of America, the National Taxpayers Union and the American Farm Bureau Federation. The farm group has accused coal and electric utility interest—who are lobbying for changes in Staggers—of “seeking to avoid” their full share of the costs of the rail system upon which they claim to be totally dependent. Observed Forbes magazine of efforts to deregulate the railroads:

A sorry spectacle. The whole affair is an embarrassment to free enterprisers. A lot of business people who give lip service to free markets and to deregulation are trampling on their own principles in the hope of a monetary advantage.190

Isabel H. Benham, described by Forbes as the “dean of U.S. railroad analysts,” explained:

This act (Staggers) gave freedom to the railroads in ratemaking, routing, abandonments, marketing and creating of unit trains, and no railroad in the country has benefited as much as Conrail has. Deregulation provided the marketing tools to compete with the trucker—rates can be changed within

hours instead of months—and since Conrail is probably the most truck-sensitive railroad in the country, this has been a major boon.
I'm so very optimistic. However, if there is any fine-tuning of the Staggers Act or if it is repealed, then Conrail, and probably every other railroad in the whole country, is doomed. In my opinion, the viability of Conrail and the preservation of the Staggers Act are inextricably interlined. 191

In a recent editorial, following Conrail's return to the private sector, Barron's publisher Robert M. Bleiberg concluded, "Don't derail progress. Moves to reregulate should be stopped in their tracks." 192

XII. THE STUFF OF FREE MARKETS

Clearly, the Staggers Rail Act is working as intended—for railroads, for shippers and certainly for society.

Staggers is working as intended because rail service has improved. The array of price/service options available to shippers has increased. Many rail rates have declined. Overall, rail rate levels are not rising as fast as they were perversus to the Act's passage. In fact, as indicated in an earlier section, overall rail rates actually have declined in real terms.

Staggers is working as intended because greater reliance is being placed upon free markets.

Under stringent economic regulation, buyers of rail transportation often couldn't buy all they sought—at any price—and sellers often found themselves with excess capacity that they couldn't sell—at any price.

Events of the 19th Century that led to creation of the Interstate Commerce Commission in 1887 have given way to competitive realities of the late 20th Century. Today, the vast preponderance of all rail freight service faces intense competition, from modes that evolved and expanded well after the rail regulatory system was conceived, as well as from other railroads. 193

Deregulation has permitted railroads to use the tools of the free-market—contract, market-induced price reductions and increases, product-line expansions and contractions—to better meet the varied wants of the marketplace. In the words of Oregon Senator Bob Packwood, "There is no reason why we should be controlling capitalistic acts by consenting adults." 194

Opponents of rail deregulation ignore its positive results. Instead of focusing upon efficiency gains stemming from less government involve-

194. Senate Panel Sends Truck Bill to Floor, Congressional Quarterly, March 15, 1980, at 753.
ment, they incorrectly focus on the number of rail suppliers serving a fixed point. They assert that railroads—despite the existence of intramodal, intermodal, product and geographic competition—remain a transportation monopoly requiring continued economic regulation.

In fact, the vast number of beneficiaries of rail deregulation are too busy reaping the widely dispersed benefits to broadcast their gains. It is a minority of unhappy shippers—unhappy not because they can show railroad abuse of market freedoms, but because they believe they can gain a better deal under strict regulation—who are spending a disproportionate amount of resources seeking alterations. It is almost exclusively the minority voice that is being heard on Capitol Hill.

The fact is, however, that railroads no longer are monopolies. Every business has some limited market power. The corner gas station has market power on the corner it serves, as does the supermarket or drugstore on the block it serves. What distinguishes these enterprises from monopolies is that other sellers can compete on another corner or on the next block.

So it is with railroads. Though the Burlington Northern (BN) appears to have market power in some North Dakota towns, the BN does not have a monopoly. This is because the Soo Line sells a similar railroad service in nearby towns, and because substitute motor-carrier service can be obtained in every North Dakota town—and because it is in BN’s self-interest to assure that shippers located on its lines can compete with shippers located on other rail lines.

Though the Norfolk Southern (NS) appears to have market power over coal shipments from Southwest Virginia in West Virginia, NS does not have a monopoly. This is because electric utilities and steel mills buying steam and choking coal in the NS region can purchase it from mines located on Chessie or Conrail lines, or substitute barge for rail.\footnote{Virginia Power, for example, has begun barging coal from Norfolk to a power station on the James River near Richmond. If rail rates from the coal fields via NS to Norfolk are perceived to be "too high," Virginia Power can move coal from other mines via Chessie to Newport News or Baltimore, or via Conrail to Philadelphia—all for subsequent barging. New England Energy has used similar tactics to create competition—even going to foreign-produced coal and completely bypassing the U.S. rail network. \\Utility Tests Barging of Coal, Journal of Commerce, Nov. 25, 1985.} Again, NS and its shippers are in partnership to assure that the coal they mine and carry can compete.

Coal-hauling railroads face additional competitive pressures because of the ability of utilities they serve to purchase foreign-produced coal; to build future power plants at the seashore or on rivers; to substitute natural gas, fuel oil or nuclear power for coal; or to buy surplus generating ca-
pacity from other utilities served by other railroads or barges. 196

Competition does have a price—the price to buyers of finding alternatives. Sadly, almost a century of economic regulation has left many buyers of freight transportation unprepared for the basic comparison shopping that characterizes all of our other business decisions.

Railroads have not been totally deregulated. If railroads charge non-competitive prices, there are regulatory avenues still available to curb abuse. The fact is, however, that even before regulatory relief arrives, the offending railroad(s) most probably will see existing and potential traffic move via other modes; traffic evaporates as substitute products are found; or traffic disappears as buyers secure their products from other geographic areas served by other railroads.

Railroads are generally as vulnerable to a loss of business resulting from non-competitive pricing practices as are corner gas stations, supermarkets or drugstores.

The proper measurement of successful public policy is the excess of benefits over costs. The free-market tenets of Staggers have dramatically increased public benefits and markedly reduced public costs.

XIII. CONCLUSION

It was barely a decade ago that more than 21 percent of the nation’s rail mileage was mined in bankruptcy. Some 47,000 miles of track, suffering deferred maintenance, were restricted to speeds of as slow as 10 miles per hour. Freight-car and locomotive shortages were common. Transit times were inconsistent; loss and damage claims high.

A steady erosion of rail business to other modes had pushed the railroads’ share of intercity freight tonnage to less than 37 percent; and the railroads’ share of intercity freight revenues to below 18 percent. Still, federal and state government continued to regulate railroads as if they were a monopoly.

Rail-competitive motor carriers and barge operators—favored with substantially less economic regulation—enjoyed greater flexibility in pricing and marketing, allowing them to siphon the railroads’ business with impunity. And since truck and barge operators enjoy subsidies in the form of government constructed and maintained rights-of-way—with user

196. The electric utility industry can produce at least 36 percent more peak-load power than it sells—growing to 50 percent by the end of the decade. In 1986, Metropolitan Edison began periodically closing its Reading, Pa., coal-fired generating station and began purchasing nuclear generated electricity from Philadelphia Electric Co. According to the National Coal Assn., “Coal companies in domestic markets are finding it difficult to compete with oil and gas and nuclear power.” Why Cheaper Electricity May be on the Way to Consumers, BUSINESS WEEK, Oct. 29, 1984; Statement by Jerome Karaganis, Vice President, Economics, National Coal Association in Coal Age, April, 1987, at 11.
charge levels far below cost recovery levels—these competitors often offer lower rates than railroads, which have no such subsidies. Economic efficiency is not served when freight allocation is made on the basis of taxpayer subsidies rather than inherent advantage.

Regulatory delay made it increasingly difficult for railroads to adjust their prices and service to market conditions, to abandon money-losing track, or shed unprofitable lines of business. Social-welfare objectives—requiring railroads to grant preferential treatment to certain producers, ports and regions, and to act as employer of last resort—received greater weight in regulatory hearings than the railroads’ need for adequate revenues.

Throughout the early and mid-1970s, Congress attempted a series of “Band-Aid” approaches, directed more at the symptoms of the railroad decline rather than the causes. The “Band-Aid” solutions, predictably, were not successful.

The fear of additional rail bankruptcies, the specter of nationalization and a recognition that tax dollars are scarce all combined to focus Congress on the fact that government interference was causing massive inefficiencies among transportation modes. As the decade of the 1970s came to a close, Congress acknowledged that bureaucracies are ill-equipped for central planning; that free markets are the most efficient and the most equitable.

Thus, in 1980, Congress ought to treat railroads more like other businesses. It passed the Staggers Rail Act, which provided railroads with a healthy dose of deregulation. The principal goal of the Staggers Act was to preserve a viable private-sector rail system, relying to the fullest extent possible on market forces. Regulation was to remain in effect only where necessary to prevent abuses of market power.

Since passage of Staggers, deferred maintenance on mainline track virtually has been eliminated. The railroads’ safety record has improved substantially. Freight loss and damage payouts are at an all-time low. Equipment shortages have given way to equipment surpluses. Productivity has been improving; operating costs falling. Where trains once lurched at ten m.p.h., many now travel at seventy m.p.h., with arrival times guaranteed. Investment in research and development is at record levels.

Many rail rates have been dropping. Overall, rail rates are rising far less rapidly than they did prior to the Act’s passage. In fact, average rail rates—when adjusted for inflation—have declined by almost 5 percent since passage of the Staggers Act. More than 60 percent of the coal and grain hauled by railroad moves under contracts negotiated between railroads and their customers. In many markets, railroads are now compet-
ing more successfully against trucks and barges—though rights-of-way subsidies to those modes continue to keep the playing field uneven.

Rail profits still lag the level of profits enjoyed by American industry in general and are still well below the revenue adequacy test employed by every other business. Those substandard profits may be further battered as America completes its shift from a primarily industrial-based nation to one of greater service concentration. However, it has been the marketing freedoms bestowed by Staggers that permitted railroads to weather a long and deep recession, and the fundamental changes in the economy that are taking place.

Optimism runs high among rail management that the nation’s rail system can be rationalized within the private sector to meet the changing economic environment. More competitive labor contracts and creation of regional and short line railroads out of previously uneconomic rail lines is evidence of such progress.

Completion of the rationalization task—which will increase traffic densities, further pare operating costs and position railroads to compete more aggressively for business now moving by highway—is dependent upon retention of the marketing freedoms granted by the Staggers Act.

The overwhelming majority of rail shippers praise the results of rail deregulation, which is reflected in more competitive rates, and restoration of reliable and consistent service. A host of studies, many by government agencies and other neutral observers, confirm that railroads are not abusing their market freedoms.

Where problems have developed with shippers, good faith negotiations are resulting in equitable solutions. Still, a minority of shippers are demanding reregulation of the railroads—convinced they can gain a "better deal" for themselves from regulators. The voice of this minority has been amplified because the overwhelming majority of shippers who have benefited from deregulation are busy tending to their own businesses. A group of more than 300 satisfied shippers has been formed, however, to counter the lobbying activities of the mostly coal and electric utility shippers who are complaining.

Data and events make very clear that the Staggers Act is the most successful transportation legislation ever passed by Congress. After years of trying to survive in Washington, rail managers are learning to survive in the marketplace.
Airport Noise: The Proprietor's Dilemma

GALE SCHLESINGER

I. INTRODUCTION

The airport noise problem can best be identified by the differing perceptions of the public/airport neighbor, air carrier and airport proprietor. According to the airport neighbor, noise produces stress. It disrupts daily activities including sleep, and interferes with television viewing and conversation. Airport neighbors perceive the problem as one of insensitivity by the air carriers and officials responsible for their distress.

Because individual airports adopt their own noise mitigation measures, the air carrier views noise control as fragmented, inefficient, and confusing. Air carriers perceive the problem in economic terms, as an obstacle to their growth, limiting their market opportunities.¹

The airport proprietor faces a serious dilemma. "At the same time that the airport sponsor wants to facilitate the growth of air commerce, it must recognize that the local citizenry has reasonable expectations for an environment free of intolerable levels of noise resulting from aircraft operations."²

This paper focuses on the various noise mitigation measures adopted by airport proprietors throughout the country in response to their dilemma. Proprietary authority to impose noise restrictions will be re-

². Id.
viewed under the doctrine of preemption. Constitutional limits under the Commerce and Equal Protection Clauses will be analyzed to ascertain the extent of the proprietor's ability to control noise. Finally, the proposed noise rule at Denver's Stapleton International Airport will be examined to determine whether it would withstand constitutional attack.

II. FEDERAL PREEMPTION

The judicial doctrine of preemption stems from the Supremacy Clause of the Constitution.\(^3\) The Supremacy Clause provides that state and local authorities do not possess the power to legislate inconsistently in matters already subject to comprehensive federal law. The federal statutory scheme of airport noise regulation has been cited by numerous plaintiffs as the ground for federal preemption in challenges to proprietary noise regulations.

The Federal Aviation Act of 1958\(^4\) gave the Federal Aviation Administration (FAA) authority over air safety and the nation’s navigable airspace. The FAA is given broad authority to "insure the safety of aircraft and the efficient utilization of such airspace"\(^5\) and "for the protection of persons and property on the ground."\(^6\) In 1968, Congress amended the 1958 Act by requiring the FAA to prescribe and amend standards which protect the public health and welfare from aircraft noise and sonic boom.\(^7\)

Although the statutory scheme is pervasive, the federal government has assigned primary responsibility for noise control to local authorities.\(^8\) The federal government has not preempted the entire area of airport noise control because it would then be liable for all takings due to noise related damages.\(^9\)

In Griggs v. Allegheny County,\(^10\) the Supreme Court held the local proprietor of the Greater Pittsburgh Airport, rather than the United States, liable for an unconstitutional taking of an air easement over plaintiff's property. Plaintiff's home was 3,250 feet from the end of a runway where planes passed within altitudes of thirty feet. Since, under Griggs, the airport operator bears the financial burden for aircraft noise related dam-

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5. Id. § 1348(a) (1982).
6. Id. § 1348(c) (1982).
7. Id. § 1431(b)(1) (1982).
ages, it should have the right to control the noise causing that damage.\textsuperscript{11}

However, in \textit{City of Burbank v. Lockheed Air Terminal Inc.},\textsuperscript{12} the Supreme Court invalidated a local noise regulation based on preemption. Private owners of the Hollywood-Burbank Airport brought suit against the City of Burbank, which had imposed a based curfew resting on the City’s police power. The finding of preemption was based on the pervasive nature of the federal statutory scheme.\textsuperscript{13} Additionally, the court stated that if the curfew was upheld and a significant number of municipalities followed suit, the FAA’s flexibility in controlling air traffic would be limited.\textsuperscript{14}

It appears from footnote 14 of the decision that regulations based on police power are preempted so that an airport would not be subject to conflicting regulations.\textsuperscript{15} If a municipality which was not the airport proprietor exercised its police power, an airport could be subject to a number of conflicting regulations.\textsuperscript{16}

\textit{Burbank} limited preemption to noise regulations resting on the exercise of police power. Footnote 14 left open the possibility that the airport proprietor could regulate aircraft noise as long as it did not control flight or aviation safety.\textsuperscript{17} Thus, \textit{Burbank} created an exception in the area of airport noise regulation: proprietary noise measures are not preempted as long as they do not interfere with the FAA’s role. The following cases illustrate this exception.

In \textit{Air Transportation Association v. Crotti},\textsuperscript{18} plaintiff sought relief from noise standards adopted by the California Department of Aeronautics on the ground of preemption. The court upheld the CENEL (Community Noise Equivalent Level) standard, which prescribes a maximum level of noise, because it did not interfere with the FAA’s responsibility for regulating aircraft engaged in flight. Because the SENEL (Single Event Noise Exposure Level) standard prescribes a maximum noise level for aircraft engaged in flight, it was preempted.\textsuperscript{19} The court criticized plaintiff’s reliance on \textit{Burbank} to invalidate the regulations. The court interpreted footnote 14 of the \textit{Burbank} decision to represent the principle that proprietary measures not interfering with the FAA’s role were outside the scope of preemption.\textsuperscript{20}

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\textsuperscript{11} Note, supra note 8, at 342.
\textsuperscript{12} City of Burbank v. Lockheed Air Terminal Inc., 411 U.S. 624 (1973).
\textsuperscript{13} Id. at 633.
\textsuperscript{14} Id. at 639.
\textsuperscript{15} Id. at 636.
\textsuperscript{16} Note, supra note 8, at 341.
\textsuperscript{17} 411 U.S. at 636.
\textsuperscript{18} 389 F. Supp. 58 (N.D. Cal. 1975).
\textsuperscript{19} Id. at 65.
\textsuperscript{20} Id. at 64.
\end{flushright}
In *Global*, several airlines sought to enjoin enforcement of the "Interim Rule" imposed by the Port Authority. The Rule limited the percentage of takeoffs and landings of stage I aircraft at the Port Authority's airports. The Rule imposed stricter standards than the federal Fleet Compliance Program which established a timetable for the elimination of stage I aircraft. In *Global II* the second circuit reaffirmed *Global I*, which held that the Rule was not preempted. The rule did not conflict nor present an obstacle to the federal Fleet Compliance Program. Thus, *Global* reaffirms the right of "airport proprietors to establish requirements as to the level of permissible noise created by aircraft using their airports."23

III. CONSTITUTIONAL RESTRICTIONS

The airport proprietor's ability to control noise restrictions is not unlimited. Though not preempted, the proprietor is subject to the following Constitutional restrictions: (1) the airport proprietor may not impose an undue burden on interstate commerce, and (2) may not unjustly discriminate between different categories of airport users.24

A. COMMERCE CLAUSE

The report of the Airport Access Task Force states, "Airport proprietors generally have been cautious about adopting some types of use restrictions, knowing that they have a duty to avoid burdening interstate commerce . . . . The result is that few single use restrictions at a single airport can be shown to burden interstate commerce. . . ."25 The test applied to determine if a proprietary noise regulation is unduly burdensome is highlighted by several recent cases which indicate that a regulation will not be stricken if its effect on interstate commerce is only incidental.

A U.S. District Court espoused the following multistep test in *National Aviation v. City of Hayward*26 to determine if a curfew banning all aircraft between 11:00 p.m. and 7:00 a.m. which exceeded a specified noise level was unduly burdensome. First, determine if there is an effect on

22. Stage I aircraft are the noisiest and oldest of the three categories of jet aircraft established by the FAA. Stage II aircraft are quieter than Stage I, and Stage III aircraft are the most technically advanced and quietest aircraft. 34 Fed. Reg. 18,355 (1969) (codified as amended at 14 C.F.R. Part 36 (1986)).
interstate commerce. If there is no effect the inquiry is over. Second, determine if the "legislative body 'acted within its province, and whether the means of regulation chosen are reasonably adopted to the ends sought." 27 This step includes determining whether the regulation discriminates against interstate commerce. Third, the burden on commerce must be balanced against the local interests supporting the legislation. The Hayward court relied on the Supreme Court's most recent formulation of this standard: "Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." 28

Plaintiffs challenged the curfew as unduly burdensome because it forced them to operate from Oakland Airport rather than the Hayward Air Terminal, thereby impairing their ability to deliver cargo. The court found that the effect was incidental, at best, because (1) some of plaintiffs' aircraft could comply with the regulation, (2) plaintiffs could shift operations to the Oakland Airport when necessary and, (3) plaintiffs' deliveries were at the same level with the regulation as without it. It was, therefore, determined that the effect of the curfew was clearly not excessive when weighed against the legitimate goal of controlling noise. 29 Thus, Hayward represents the principle that a noise regulation will be upheld under the Commerce Clause even if it has some effect on interstate commerce.

In Arrow Air, Inc. v. Port Authority of N.Y. and N.J., 30 plaintiff sought relief from enforcement of the Final Rule established by the Port Authority. The Rule did not allow stage I aircraft to operate at the Port Authority's airports. Plaintiff argued that the Rule was unduly burdensome because it would alter its market and cause economic harm. However, the court dismissed plaintiff's argument by stating that the Final Rule only imposed an incidental burden. The burden was considered incidental because the service plaintiff provided to particular cities without the Rule was comparable to service which could be provided by other carriers with the Rule. 31 The court referred to Exxon Corp. v. Governor of Maryland, which stated that "the [Commerce] Clause protects the interstate market, not particular interstate firms, from prohibitive or burdensome regulations." 32 Thus, Arrow Air represents the principle that if service comparable to that pro-

27. Id. at 425 (quoting South Carolina Highway Dep't v. Barnwell Bros., 303 U.S. 177, 190 (1938)).
28. Id. at 426 (quoting Pike v. Bruce Church Inc., 397 U.S. 137, 142 (1970)).
29. Id. at 427.
31. Id. at 321.
vided without a noise regulation can be provided with the regulation, interstate commerce is not unduly burdened.

B. **Equal Protection**

The standard for reviewing airport noise regulations under the Equal Protection Clause was established in *British Airways*: proprietary regulations must be "fair, reasonable, and nondiscriminatory."\(^{33}\) In the final decision of *British Airways*, the appellate court reaffirmed the district court's decision to dissolve a proprietary regulation banning the Concorde at John F. Kennedy International Airport. The ban was challenged because the Concorde could meet the maximum permissible noise standard established by the Port Authority. The decision to invalidate the ban was based on the Port Authority's lack of responsibility in setting a noise standard applicable to the Concorde within a reasonable time. Thus, it was the Port Authority's failure to act which was held to be "unreasonable, discriminatory, and unfair" that lead to invalidation of the ban.\(^{34}\)

In *Santa Monica Airport Association v. City of Santa Monica*,\(^{35}\) plaintiff challenged the following five regulations imposed by the City of Santa Monica as discriminatory: (1) a night curfew, (2) a noise level restriction defined by the SENEL standard, (3) a ban on helicopter flight training, (4) a weekend and holiday ban on touch-and-go training operations of propeller aircraft, and (5) a total ban on jet aircraft.\(^{36}\)

To determine if the regulations were discriminatory, the court stated that the regulations must be rationally related to a legitimate state interest. The court applied this standard because the ordinances in question did not involve any suspect classification or fundamental rights. The regulations were regarded as economic, subject only to the rational basis test.\(^{37}\)

Each ordinance except the jet ban was upheld as a reasonable means to achieve the community's interest in preventing noise. The jet ban was held as discriminatory because there was no difference between the noise emitted by business and executive jets which were denied access and propeller aircraft which were granted access. Therefore, the ban did not further the community's goal of preventing noise.\(^{38}\)

In *Arrow Air*, the court also applied the rational basis test to determine that the Port Authority's Final Rule was not administered in a discriminatory manner. Plaintiff claimed that the Port Authority discriminated by permitting other air carriers to operate certain stage I aircraft while

\(^{33}\) British Airways Bd. v. Port Auth. of N.Y. & N.J., 558 F.2d at 82.


\(^{36}\) Id. at 930.

\(^{37}\) Id. at 935.

\(^{38}\) Id. at 944.
plaintiff could not operate its stage I aircraft. In dismissing plaintiff’s argument, the court stated that the particular stage I aircraft granted access were quieter due to flight procedures established by the Port Authority. Thus, the Final Rule was upheld as nondiscriminatory because the Port Authority established reasonable procedures to insure compliance.\textsuperscript{39} Arrow Air reaffirms the standard for review espoused in Santa Monica: discrimination will be found when a regulation denies access to a class of aircraft users emitting the same level of noise as a class granted access.

III. AIRPORT NOISE LIMITATION PROGRAM AT STAPLETON INTERNATIONAL AIRPORT (SIA)

The City and County of Denver has recently been confronted with the proprietor’s dilemma. Pursuant to an intergovernmental agreement between Denver and Adams Counties, Denver is required to adopt a noise Rule (The Airport Noise Limitation Program) governing the level of noise emitting by aircraft.\textsuperscript{40} The purpose of the Rule is to place a cap, or ceiling, on noise emitted by all aircraft operating at SIA. The precise cap will be determined from the total noise emitted by all aircraft during an established base period. In effect, the cap creates a bubble over SIA, which is a novel concept in the area of airport noise regulation.

Generally, the Rule, which has not yet been finalized, limits the amount of noise a nonexempt carrier can emit. Exemptions are allowed for air carriers emitting a de minimis level of noise, not significantly contributing to total airport noise. Exemptions are also allowed for operations providing international service, operations of the United States, and special hardship cases. Each air carrier is issued a noise certificate which allocates the amount of noise their aircraft can emit during a specified time period. Allocations to incumbents are determined by calculating the total noise produced at takeoff and landing by types of aircraft operated by the incumbent during the base period.\textsuperscript{41} Noise is allocated to new entrants from a noise bank which is comprised of five percent of the total noise emitted by all air carriers during the base period.\textsuperscript{42} The Rule provides for alienability of noise certificates in part or in their entirety. Additionally, the Rule provides penalties for an air carrier emitting noise in excess of its allocation.

\textsuperscript{40} Adams County, Colo. and City and County of Denver, Colo., Intergovernmental Agreement Regarding New Stapleton Runway(s) and Noise Mitigation Measures (June 25, 1986).
\textsuperscript{41} The Rule defines Incumbents as air carriers emitting noise above the de minimis level on the date of implementation of the Rule.
\textsuperscript{42} The Rule defines new entrants as air carriers which are (1) not exempt, or (2) are not operating at SIA at the date of implementation of the Rule and wish to operate above the de minimis level, or (3) are presently operating on the de minimus level.
Because no Tenth Circuit decisions have involved airport noise regulations, it is difficult to determine if the Rule would withstand constitutional attack. However, it can be argued that the standards espoused by the federal courts should be relied upon to determine the Rule's constitutionality. Therefore, the general tests for proprietary actions can be applied, which require that the Rule must not (1) interfere with the FAA’s responsibility for controlling the navigable airspace, (2) impose an undue burden on interstate commerce, and (3) be discriminatory.

A. PREEMPTION

It is likely that both the FAA and air carriers will challenge the Rule based on preemption, the Commerce Clause, and the Equal Protection Clause. It is unlikely that the Rule would be held as preempted because it does not interfere with the FAA's role in controlling the navigable airspace. The Rule does not prescribe a limit for noise emitted by aircraft engaged in flight. The Rule prescribes a limit for noise emissions as measured on the ground; allocations are based only on the noise produced on takeoff and landing.

B. COMMERCE CLAUSE

The Rule may be challenged by the FAA, on behalf of all air carriers, as unduly burdensome on the ground that the Rule markedly reduces the total number of scheduled operations that can be conducted by air carriers at SIA with the existing mix of quiet and noisier aircraft. A recent Notice of Proposed Policy states that the FAA is solely responsible for determining the capacity of airport runways open to the public.43 If capacity of the SIA runway system is significantly reduced by implementation of the Rule and is lower than that accepted by the FAA, it may be determined that the burden on interstate commerce is more than incidental. Such a finding would invalidate the Rule under the Commerce Clause.

However, if capacity is not significantly reduced, the effect of the Rule would be deemed incidental. As case law illustrates, when the effect on commerce is incidental, it is likely that the Rule will be upheld under the Commerce Clause.

Individual air carriers may challenge the Rule as unduly burdensome on the ground that it causes economic hardship, forcing the reduction and perhaps, elimination of service to particular cities. The air carrier could argue that economic hardship is caused because compliance forces the

43. 51 Fed. Reg. 2985, 2986 (1986) (proposed Jan. 22, 1986) ("[The FAA] reserves for itself the right to determine efficient and safe runway and taxiway operating levels, and to impose operational limits and allocation procedures in such situations.").
carrier to use quieter aircraft which is more expensive and seats more passengers than necessary to meet market demand. Therefore, the air carrier can not afford to provide service to particular cities using quieter aircraft.

As espoused in Arrow Air, commerce is not unduly burdened if certain airlines discontinue service to a particular city provided that other airlines can provide comparable service. A finding that comparable service can not be provided may very well invalidate the Rule under the Commerce Clause.

C. EQUAL PROTECTION

It is likely that the Rule will be challenged by air carriers under the Equal Protection Clause on the grounds that (1) it unreasonably discriminates against incumbents who operated quieter aircraft during the base period in favor of those which operated noisier aircraft, and, (2) it unreasonably discriminates against new entrants who are denied operating rights in favor of incumbents.

As a basis for the first challenge, the “quieter” incumbent might argue that the Rule is unreasonable because operating rights are determined according to the base period. Therefore, the method of allocation penalizes the “quieter” incumbent. As a basis for the second challenge, a new entrant could argue that the Rule is unreasonable because operating rights are determined according to the share of noise available, which is insufficient in contrast to the incumbents’ share.

In applying the standard for review, the Rule will be invalidated if it is determined that the method of noise allocation is not rationally related to Denver’s interest in placing a cap on noise. However, several arguments can be made to illustrate that the method of noise allocation does not violate the Equal Protection Clause. First, the Rule is reasonable because it forces air carriers to pay for the noise they emit. As the Airport Access Report states, air carriers “do not bear the true ‘social cost’ of their activities. . . . However, if social costs . . . can be identified those costs can be reflected in aircraft operations.”44 The Rule transfers the financial cost of operations in excess of an allocation to the air carrier in the form of a penalty or the market price for purchasing another air carrier’s allocation. Thus, the Rule can be regarded as reasonable because it provides an economic incentive for compliance.

Secondly, it can be argued that the Rule is reasonable because it provides for an increase in operations through alienability of noise certificates. If necessary, an air carrier can increase operations by obtaining noise from another air carrier. Thus, the Rule provides flexible proce-

44. Airport Access Report, supra note 1, at 62.
dures for growth. The Rule provides additional flexibility because it does not mandate the type of aircraft each air carrier must include in its fleet. An air carrier can choose the mix of quiet and noisier aircraft necessary to achieve compliance. Finally, the Rule is nondiscriminatory because access is granted to all classes of airport users. The Rule does not favor any particular class since allocations are based on the level of noise emitted and exemptions are based on the de minimis level of noise.

IV. CONCLUSION

The likelihood of challenge to an airport noise regulation is great considering the public and air carrier’s perceptions of the noise problem. If the Rule at SIA is attacked on constitutional grounds, case law illustrates that the City and County of Denver is not preempted if the regulation does not interfere with the FAA’s responsibility for controlling aircraft in flight and aviation safety. However, Denver’s dilemma will remain unresolved if it is determined that the Rule imposes an undue burden on interstate commerce or is discriminatory. Hopefully, participation by representatives of the neighboring communities and air carriers will decrease the likelihood of litigation. If the Rule at SIA does withstand constitutional attack, a precedent in the area of airport noise regulation may be established for major airports throughout the country.
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